

SCOTTISH LAW COMMISSION
(Scot Law Com No 191)



Report on Irritancy in Leases of Land

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The Scottish Law Commission was set up by section 2 of the Law Commissions Act 1965¹ for the purpose of promoting the reform of the law of Scotland. The Commissioners are:

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

SCOTTISH LAW COMMISSION

Item No 2 of our Sixth Programme of Law Reform

Report on Irritancy in Leases of Land

To: Ms Cathy Jamieson MSP, Minister for Justice

We have the honour to submit to the Scottish Ministers our Report on Irritancy in Leases of Land

(Signed) RONALD D MACKAY, *Chairman*
GERARD MAHER
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Miss Jane L McLeod, *Secretary*
27 May 2003

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Part 1 Introduction

Background to the report

1.1 In October 2001 we published a discussion paper¹ on irritancy in leases of land. Irritancy is a remedy available to a landlord either under the lease (when it is called a "conventional" irritancy) or under the general law (when it is called a "legal" irritancy), allowing the landlord to terminate the lease prematurely. This right arises most typically where the tenant is in breach of the lease obligations, but the irritancy clause may provide that the right to irritate is triggered by an event unconnected with those obligations. The most common example of such an event is a change in the financial status of the tenant, typically insolvency, liquidation or receivership.² Upon irritancy, the tenant loses his rights under the lease and has no claim for compensation or recompense unless the lease provides otherwise. It is therefore a powerful remedy with important consequences for both parties.

1.2 A review of the law in this area was included in our Sixth Programme of Law Reform³ in response to criticism in the House of Lords⁴ of the potentially harsh effects of conventional irritancy. However, the scope of our consideration was not restricted to the circumstances of the litigation in question and encompassed all types of irritancy in leases of commercial property. We also asked whether our proposals for reform should be extended to agricultural leases.

1.3 The discussion paper identified a number of difficulties with the existing law, which in our view merit reform. These are described briefly below.

Conventional irritancy and the 1985 Act

1.4 The Law Reform (Miscellaneous Provisions) (Scotland) Act 1985 ("the 1985 Act") introduced mandatory rules⁵ on the exercise of conventional irritancy in commercial leases. Residential and agricultural leases were excluded from the scope of the Act.⁶ It implemented recommendations made by this Commission in its Report on *Irritancies in Leases* published in February 1983.⁷

1.5 The protection afforded to the tenant of a lease to which the 1985 Act applies differs according to the nature of the event triggering the landlord's right to irritate. In cases of

¹ Discussion Paper on *Irritancy in Leases of Land*, Scot Law Com DP No 117 (referred to in this report as "the discussion paper").

² In this report such events are referred to as "insolvency events affecting the tenant". For a full definition of this term see paras 3.43ff below and draft Bill, s 19(1).

³ Scot Law Com No 176, Item No 2: Obligations.

⁴ *CIN Properties Ltd v Dollar Land (Cumbernauld) Ltd* 1992 SC (HL) 104. *Sub nom Dollar Land (Cumbernauld) Ltd v CIN Properties Ltd* 1998 SC (HL) 90.

⁵ S 6(1).

⁶ The 1985 Act applies to leases of land except if used wholly or mainly for residential purposes or leases comprising an agricultural holding, a croft, the subject of a cottar or the holding of a landholder or a statutory small tenant; s 7. It does 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).

⁷ Scot Law Com No 75.

monetary breach section 4 provides that the landlord must serve a warning notice on the tenant requiring the tenant to pay the arrears within 14 days or such longer period as may be provided in the lease. The landlord may only proceed to exercise his rights under the irritancy clause if the tenant fails to comply with the terms of the notice. On expiry of the notice the irritancy is no longer purgeable, that is to say, it cannot be avoided by payment of the rent.

1.6 In relation to irritancy in respect of an act or omission of the tenant (other than non-payment of a sum due) or of a change in the tenant's circumstances, section 5 provides that the landlord cannot exercise his right of irritancy unless in all the circumstances of the case a fair and reasonable landlord would do so. In evaluating the test, where the irritancy relates to a remediable breach, regard must be had to whether the tenant has been given a reasonable opportunity to remedy the breach.⁸ However, there is no obligation on the landlord to serve a warning notice on the tenant requiring him to remedy the breach within a specified time under threat of irritancy.

1.7 The 1985 Act reforms, coupled with the court's existing common law equitable power of relief,⁹ were designed to avoid harsh and arguably "unfair" results on the enforcement of irritancy clauses while at the same time preserving the landlord's legitimate remedy for non-performance of obligations under the lease. However, in practice, the application of these statutory provisions has proved problematic.

Problems with the application of section 4 of the 1985 Act

1.8 The limitations of the protection provided by section 4 were explored by the courts in *CIN Properties Ltd v Dollar Land (Cumbernauld) Ltd*.¹⁰ The facts of the case can be described briefly. The mid-landlord of a shopping centre development irritated the sub-lease on account of late payment of rent. The requisite warning notice was served. The mid-landlord rejected the sub-tenant's attempt to tender payment after the warning notice had expired. The sub-tenant, who would lose its investment in the shopping centre of around £2.2 million, unsuccessfully defended the action for declarator of irritancy.

1.9 The House of Lords¹¹ upheld the principle that conventional irritancies are not purgeable and therefore on expiry of the warning notice the mid-landlord was justified in refusing to accept the late payment of rent. It was also held that the mid-landlord's use of the irritancy was not oppressive in the circumstances and the common law equitable power of relief could not be invoked. Therefore their Lordships felt that they had no option but to grant declarator of irritancy for non-payment of rent since the landlord had complied with the requirements of section 4.¹²

1.10 The sub-tenant then raised an action of recompense in an attempt to recover the mid-landlord's gain. Eventually the House of Lords held that the mid-landlord was not obliged to disgorge the development value of the land under the law of unjustified enrichment. Since the mid-landlord's enrichment flowed from its contractual right to irritate the sub-

⁸ S 5(3).

⁹ See para 1.17 below.

¹⁰ 1992 SC (HL) 104. *Sub nom Dollar Land (Cumbernauld) Ltd v CIN Properties Ltd* 1998 SC (HL) 90.

¹¹ 1992 SC (HL) 104.

¹² See the discussion paper, paras 3.20ff.

lease, it could not be treated as unjustified.¹³ While the law was clear, the House of Lords did not regard the outcome as satisfactory. In particular, they did not feel able to develop the law in a way which would render the effects of enforcement of the irritancy clause less penal, for example, by annexing conditions to the granting of a decree of irritancy whereby the mid-landlord would have to compensate the sub-tenant for the value of any improvement to the land which had been carried out by the sub-tenant or its predecessors. Their Lordships considered that the 1985 Act did not go far enough to prevent "unfair" results.¹⁴ They expressed concern that the potentially serious economic consequences of irritancy for tenants (especially conventional irritancies which are not purgeable) might have a detrimental effect on financial investment in commercial property in Scotland.¹⁵ These concerns led in part to the current review of the law of irritancy.

Problems with the application of section 5 of the 1985 Act

1.11 The operation of the fair and reasonable landlord test contained in section 5 has also proven problematic. This can be illustrated briefly by examples from reported cases.¹⁶

1.12 **Change in the status of the tenant.** The case of *Blythswood Investments (Scotland) Ltd v Clydesdale Electrical Stores Ltd (In Receivership)*¹⁷ concerned the landlord's attempts to irritate the lease following the appointment of a receiver to the tenant company. The receiver was in the process of negotiating an assignation of the lease. The question before the court was whether a fair and reasonable landlord would irritate in these circumstances. The court rejected the contention that the fair and reasonable landlord test involved a simple comparison of the prejudice caused to either party. Nor did the test involve the court making an objective assessment of what constitutes fair and reasonable behaviour. Rather, the court interpreted section 5 as requiring it to consider what a fair and reasonable landlord in the position of the actual landlord would have done in the particular circumstances of the individual case. Given the width of the statutory language, account had to be taken of the economic consequences for both parties of granting or refusing to grant declarator of irritancy. In cases involving insolvency events, the interest of the insolvency practitioner responsible for the administration of the insolvency in attempting to realise a valuable asset for the benefit of the tenant's creditors must also be taken into account.¹⁸ As a result of this construction of section 5, lengthy proofs of the particular circumstances of each case are required and the judiciary must make decisions on commercial issues. It seems unlikely that this was the legislative intention behind the 1985 Act.¹⁹

¹³ 1998 SC (HL) 90.

¹⁴ 1992 SC (HL) 104 *per* Lord Keith of Kinkel at p 118.

¹⁵ "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 127.

¹⁶ For a fuller description see the discussion paper, paras 3.39ff.

¹⁷ 1995 SLT 150.

¹⁸ See also *Aubrey Investments Ltd v DSC (Realisations) Ltd (In Receivership)* 1999 SC 21 where the receiver entered into negotiations to have the lease assigned but after 4 months the negotiations broke down and the receiver failed to inform the landlord. When this was eventually discovered by the landlord, he found a potential new tenant and sought to irritate so that the new lease could go ahead. After a long and expensive proof, it was held that a fair and reasonable landlord would have irritated in these circumstances and therefore declarator of irritancy was granted. See further the discussion paper, paras 3.42-3.43.

¹⁹ *Blythswood Investments (Scotland) Ltd v Clydesdale Electrical Stores Ltd (In Receivership)* 1995 SLT 150 *per* the Lord Ordinary (Cullen) at p 155. See also Scot Law Com No 75, paras 4.7ff and the discussion paper, para 3.13.

1.13 **Obligations *ad factum praestandum*.** The case of *Euro Properties Scotland Ltd v Alam and Mitchell*²⁰ concerned the tenants' failure to comply with the repairing obligations contained in the lease and the landlord's attempt to irritate the lease on account of the tenants' breach. The court concluded that a fair and reasonable landlord in the pursuer's position would not seek to irritate the lease. It was considered important that in the particular circumstances the landlord had a separate contractual right to carry out the repair and recover the cost of doing so from the tenants.²¹ The court also accepted evidence that, following the judicial interpretation of section 5 referred to earlier, in practice it was unusual for the remedy of irritancy to be used in relation to a breach of a non-monetary obligation because it was not regarded as economically viable to do so.²²

1.14 **Conclusion.** The operation of the section 5 test involves the judicial determination of difficult commercial issues and does not fall easily within the functions of the court. The need to examine all the circumstances of each individual case may also lead to expensive and protracted proofs. The evidence we have gathered, from consultation and in discussions with our panel of legal practitioners, suggests that as a result irritancy no longer operates as an effective remedy in many such cases.

Legal irritancy

1.15 The three legal irritancies relating to non-payment of rent also fell within the scope of our review. There is a legal irritancy for non-payment of two years' rent at common law which applies to all leases. Two further legal irritancies apply to agricultural subjects: under the codifying Act of Sederunt, 14 June 1913 in respect of non-payment of one year's rent or where the tenant has abandoned the holding, and the right to raise an action for removal where six months' rent is due and unpaid under section 20 of the Agricultural Holdings (Scotland) Act 1991.

1.16 In the discussion paper we expressed the view that such irritancies are rarely, if ever, used in modern practice and should be abolished.

The common law equitable power of relief

1.17 At common law, in theory at least, the courts have an equitable power to grant relief from the misuse of irritancy. However, since 1864²³ the power has been very narrowly construed so as to be available only where abuse or oppression can be demonstrated.²⁴ We therefore concluded that it is likely that the power will rarely, if ever, be exercised. The views of consultees were sought on whether such a power had any residual value and if not, whether it should be abolished.²⁵

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

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

²¹ "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 his interest in the lease but (b) nevertheless adequately protect the landlord's interests." *Ibid per Lord Macfadyen* at para 44.

²² "I found it interesting that they both regarded irritancy of a commercial lease for breach of a non-monetary obligation as a very unusual step for a landlord to take." *Ibid per Lord Macfadyen* at para 37.

²³ When the modern interpretation of the doctrine of relief was settled; *Stewart v Watson* (1864) 2M 1414.

²⁴ See discussion paper, para 3.7; *Dorchester Studios (Glasgow) Ltd v Stone* 1975 SC (HL) 56, *CIN Properties Ltd v Dollar Land (Cumbernauld) Ltd* 1992 SC (HL) 104.

²⁵ See discussion paper, para 5.10.

Agricultural leases

1.18 Agricultural leases are regulated by the Agricultural Holdings (Scotland) Act 1991 ("the 1991 Act") and the Agricultural Holdings (Scotland) Act 2003 ("the 2003 Act"). The 2003 Act amends the terms of the existing form of agricultural tenancy under the 1991 Act ("1991 Act tenancies") and introduces two new forms of fixed term tenancies: limited duration tenancies ("LDTs") and short limited duration tenancies ("SLDTs").²⁶ The 2003 Act also provides for the Scottish Land Court ("the Land Court") to be the primary forum for the resolution of disputes arising in connection with agricultural leases.²⁷

1.19 Irritancy clauses often assume great significance in 1991 Act tenancies as a consequence of the security of tenure provisions contained in the 1991 Act. Following expiry of the initial period of the lease, 1991 Act tenancies are continued by tacit relocation until terminated by a notice to quit (given by the landlord) or a notice of intention to quit (given by the tenant).²⁸ The landlord's ability to terminate the lease by notice to quit is restricted.²⁹ In general, unless the landlord has sound agricultural reasons for terminating the lease, the tenant is protected. However, the notice to quit provisions under the 1991 Act are without prejudice to the ability of a landlord to operate a conventional irritancy clause.³⁰ Therefore, in addition to securing performance of the tenant's obligations, conventional irritancy clauses are a very useful tool for avoiding the implications of security of tenure. It should also be noted that the statutory protection from the operation of conventional irritancies afforded to tenants of commercial leases under the 1985 Act does not extend to agricultural tenants.³¹ Therefore, in the discussion paper,³² we asked consultees whether statutory protection against the effects of irritancy should be extended to agricultural leases.

1.20 SLDTs and LDTs are terminable at their ish³³ and so there is no security of tenure beyond expiry of the initial period of the lease. However, although they cannot be terminated early without agreement, this is without prejudice to the landlord's right to remove the tenant on irritancy and recover possession of the land.³⁴

1.21 In the course of the 2003 Act's passage through the Scottish Parliament no general consideration was given to the law of irritancy and how it should apply to agricultural leases. However, the Executive noted that such consideration would be carried out in the course of our review.³⁵ Nevertheless, the 2003 Act makes one minor change to the scope of

²⁶ LDTs must be for 15 years or more - 2003 Act, s 5 whereas SLDTs must be for not more than 5 years - 2003 Act, s 4.

²⁷ 2003 Act, Pt 7.

²⁸ 1991 Act, ss 3 and 21.

²⁹ S 22(1) of the 1991 Act entitles the tenant to serve a counter-notice which prevents the notice to quit taking effect unless the Land Court consents to its operation. S 24 provides that the Land Court shall consent to the operation of a notice to quit only if satisfied that one of the grounds set out in ss (1) applies. Even if satisfied that one of these grounds exists, ss (2) provides that the Land Court is bound to withhold consent to the operation of the notice to quit if in all the circumstances it appears to the Court that a fair and reasonable landlord would not insist on possession. However, s 22(2) renders a notice to quit given on certain specified grounds incontestable and the consent of the Land Court is not required for its operation. These grounds are set out in ss 22(2)(a) - (f).

³⁰ 1991 Act, s 21(6).

³¹ In our previous Report on *Irritancies in Leases* (Scot Law Com No 75), we recommended that agricultural leases should fall within the scope of our proposals for reform. However, when implementing our recommendations, the Westminster Parliament took the view that they should be excluded as it was considered that the existing legislation governing agricultural holdings was sufficient. See the discussion paper, para 1.8.

³² At para 6.31.

³³ See 2003 Act, s 6 in respect of SLDTs and s 8 in respect of LDTs.

³⁴ 2003 Act, s 19.

³⁵ Scottish Parliament, Official Report, 12 March 2003, col 19289.

irritancy as a remedy in response to a specific concern raised on behalf of tenants in the course of the parliamentary debate.

1.22 1991 Act tenancies usually include a requirement that the tenant remains resident on the farm in the interests of maintaining good husbandry, animal welfare and security. This has caused difficulty for elderly tenants who are no longer capable of living on the farm due to ill health or frailty and who are unable to assign their right in their lease to a successor.³⁶ Some cases have resulted in irritancy where the tenant has moved into residential care.³⁷ The 2003 Act amends the 1991 Act to provide that irritancy is no longer competent solely on account of a breach of a non-residency clause.³⁸ In order to protect landlords' legitimate interests in securing residency on the farm a new clause is incorporated into such leases requiring residency by a third party with suitable skills and experience.³⁹ A similar restriction on the use of irritancy is made in respect of LDTs and SLDTs.⁴⁰ However, the parties are left to agree their own means of providing for the security of the farm and maintenance of good husbandry; such provisions may be enforced through irritancy clauses.⁴¹

1.23 The 2003 Act also introduces a new policy governing the landlord's right to remove the tenant on the grounds of irritancy. In respect of LDTs and SLDTs, the landlord is required to give the tenant at least 2 months notice of his intention to remove the tenant.⁴² This is not a period within which to purge the irritancy but rather is designed to give the tenant sufficient time to remove and make alternative plans after the irritancy has been incurred. There is no equivalent period allowed to 1991 Act tenants.

Recent developments in the law of insolvency

1.24 Since the publication of our discussion paper there have been some developments in insolvency law which also have an impact on the law of irritancy. For our purposes, the relevant provisions are the amendments to the Insolvency Act 1986 by the Insolvency Act 2000 in relation to the present process of corporate administration and company voluntary arrangements ("CVAs"),⁴³ and the new administration procedure set out in Part 10 of the Enterprise Act 2002.

1.25 The purpose of these reforms is to focus upon company rescue rather than liquidation of the company's assets.⁴⁴ Where rescue is not reasonably practicable, the reforms are designed to realise the company's value in a way which is more beneficial to the company's creditors as a whole than a winding up. Only where the company is clearly not

See www.scottish.parliament.uk/S1/official_report/session-03/sor0312-02.htm#Col19289

³⁶ 1991 Act tenancies are generally not assignable on the grounds of *delectus personae*. But see now 1991 Act, s 10A to be inserted by 2003 Act, s 66.

³⁷ Scottish Parliament, Official Report, Rural Development Committee, 14 January 2003, col 4050.

See www.scottish.parliament.uk/S1/official_report/cttee/rural-03/ra03-0201.htm

³⁸ 1991 Act, s 16A to be inserted by 2003 Act, s 65.

³⁹ *Ibid.*

⁴⁰ 2003 Act, s 18(2).

⁴¹ *Ibid.*, s 18(1).

⁴² *Ibid.*, s 18(6) and (7).

⁴³ Company voluntary arrangements were introduced by Pt I of the Insolvency Act 1986 and provide a means for companies to reach a legally binding agreement with their creditors in satisfaction of their debts or a scheme of arrangements of their affairs; Insolvency Act 1986, s 1(1).

⁴⁴ Building on the recommendations in *Insolvency Law & Practice: Report of the Review Committee (Cork Report)*, (1982, Cm 8558). See also Government White Paper *Productivity and Enterprise: Insolvency - A Second Chance* (2001, Cm 5234).

viable or able to be sold as a going concern are its remaining assets to be sold in order to make payment to the secured and preferential creditors. Nevertheless, in such circumstances the interests of the ordinary creditors must not be harmed unnecessarily.⁴⁵

1.26 It is recognised that company rescue attempts may be thwarted by a landlord's exercise of a right of irritancy to bring the company's lease to an end.⁴⁶ In addition to preventing the rescue, it can give the landlord an unfair advantage over other creditors, including secured or preferential creditors, by removing a potentially valuable asset from the insolvency proceedings. Therefore the statutory provisions introduce restrictions on the exercise of rights of irritancy during the administration of tenant companies and negotiations over proposed CVAs.

1.27 From 2 April 2001,⁴⁷ during the period when an application for an administration order is pending or an administration order is in force, a landlord's right of irritancy on any ground available under the lease is suspended. If he wishes to enforce his right of irritancy, he must obtain the permission of the court, or while the administration order is in force, the consent of the administrator.⁴⁸ Similar provisions apply in respect of CVAs. From 1 January 2003,⁴⁹ a company in the process of making a proposal for a CVA may take steps to obtain a moratorium on a landlord's use of the remedy of irritancy. If the landlord wishes to enforce his right of irritancy, he must obtain the permission of the court.⁵⁰

1.28 The Enterprise Act 2002 introduces a new, streamlined procedure governing administration⁵¹ and seeks to restrict the use of receivership.⁵² Although administration is not very common at the moment,⁵³ it is envisaged that within a few years administration will become the norm in place of receivership. However, the 2002 Act adopts the same policy outlined above of restricting the exercise of irritancy during administration. Accordingly, the new administration procedure contains a similar moratorium on certain processes including:

"In Scotland, a landlord may not exercise a right of irritancy in relation to premises let to the company except -

- (a) with the consent of the administrator, or
- (b) with the permission of the court".⁵⁴

⁴⁵ See Explanatory Notes, Enterprise Act 2002, paras 647-652.

⁴⁶ See Explanatory Notes, Insolvency Act 2000, para 9.

⁴⁷ Insolvency Act 2000 (Commencement No 1 and Transitional Provisions) Order 2001 (SI 2001/766).

⁴⁸ Insolvency Act 1986, ss 10(1)(aa) and 11(3)(ba) inserted by the Insolvency Act 2000, ss 9(2) and (3).

⁴⁹ Insolvency Act 2000 (Commencement No 3 and Transitional Provisions) Order 2002 (SI 2002/2711).

⁵⁰ S 1 and sch 1 of the Insolvency Act 2000, inserting s 1A and sch A1 of the Insolvency Act 1986.

⁵¹ Sch 16 of the 2002 Act inserted into the Insolvency Act 1986 as sch B1 by s 248 of the 2002 Act. The 2002 Act received Royal Assent on 7 November 2002. The provisions on corporate insolvency are expected to be commenced early in the 2003 financial year subject to Parliamentary approval of the necessary secondary legislation. For further information on the implementation schedule see

<http://www.dti.gov.uk/enterpriseact/implementation.htm>

⁵² The appointment of a receiver is to be restricted to existing arrangements, capital markets, public-private partnerships, utilities, project finance, financial markets and registered social landlords. See ss 72A-72G of the Insolvency Act 1986 as inserted by s 250 of the Enterprise Act 2002.

⁵³ See Scottish Law Commission Discussion Paper on *Sharp v Thomson*, Scot Law Com DP No 114, para 4.1.

⁵⁴ Insolvency Act 1986 sch B1 para 43(5), as inserted by s 248 and sch 16 of the Enterprise Act 2002.

1.29 Similar provisions apply where an application for administration is pending.⁵⁵ In each case, where the court permits an irritancy to proceed, it may impose "a condition on or a requirement in connection with the transaction".⁵⁶

1.30 **Conclusion.** The statutory provisions discussed above seek to prevent the landlord from frustrating the realisation of a valuable asset in the insolvency, ie the lease, by exercising his right of irritancy. We adopt a similar policy aim in respect of our proposals for reform of irritancy on account of an insolvency event affecting the tenant.⁵⁷

Results of consultation

1.31 The discussion paper was distributed widely and received a good number of responses. We are grateful to those consultees who submitted comments.⁵⁸ There was general agreement with our assessment that the current law was in need of reform. There was also support for most of the reforms suggested. A number of difficulties with the practical detail was raised which we were able to explore in more depth with our panels of legal and insolvency practitioners.⁵⁹

Summary of proposals

1.32 **The case for reform.** There are a number of reasons why the current law requires reform. In 1985 the opportunity was not taken to extend the statutory control of irritancy to agricultural leases. The strict operation of irritancy without a requirement to give warning to agricultural tenants has resulted in cases of hardship. The opportunity to remedy this afforded by the 2003 Act was not taken due to the Executive's desire to await the imminent completion of this review. The need to consider the financial implications of recovery of possession for the landlord in applying the fair and reasonable landlord test in cases of non-monetary breach has made it more difficult to identify cases where irritancy would be unreasonable. At the same time, the need for expensive and prolonged litigation has meant that the remedy of irritancy is often seen as an impractical remedy. Recent reform of the law of insolvency shows that the interests of the tenant's creditors as a whole should be considered in addition to the landlord's contractual remedies. We believe that this principle can be applied more generally to all insolvency events affecting the tenant. Our recommendations for reform of the general law of irritancy complement the recommendations we have already made in relation to specific examples of the remedy of irritancy in other areas of property law.⁶⁰

1.33 We therefore propose a comprehensive statutory scheme regulating irritancy as it applies to leases of land. The scheme will apply to conventional irritancy clauses, however expressed, and rights to terminate the lease on account of a material breach of contract. In this regard, the scope of the scheme is the same as the 1985 Act. However, unlike the 1985

⁵⁵ Ibid, para 44.

⁵⁶ Ibid, para 43(7).

⁵⁷ See para 1.38 below. The proposals for reform are outlined in detail at paras 3.43ff below.

⁵⁸ Appendix C lists the consultees who submitted responses to the discussion paper.

⁵⁹ Appendix B lists the members of these panels.

⁶⁰ See Report on *Abolition of the Feudal System*, Scot Law Com No 168, para 4.89, Abolition of Feudal Tenure (Scotland) Act 2000, s 53; Report on *Leasehold Casualties*, Scot Law Com No 165, paras 8.4-8.8, Leasehold Casualties (Scotland) Act 2001, ss 5 and 6. See also Discussion Paper on *Conversion of Long Leases*, Scot Law Com DP No 112, para 2.22.

Act, which is restricted to commercial leases, there will be a uniform regime applying to all leases of land, including commercial, agricultural and residential leases.⁶¹

1.34 The fundamental principle underpinning the proposed scheme is that a landlord may only irritate a lease by serving a notice of termination on the tenant. The effect of a notice of termination is to terminate the lease: it will not be necessary to obtain a declarator of irritancy from the court. The circumstances in which a notice of termination may be served will be subject to statutory control. In this way a proper balance is maintained between the interests of the landlord and tenant irrespective of their respective bargaining powers.

1.35 In formulating our proposals for reform we have been aware of the need to balance a number of conflicting principles. We recognise the value of irritancy as an effective remedy. However, the consequences of the operation of an irritancy clause are so serious for the tenant that we believe that irritancy should not be allowed to operate unchecked. The type of protection to be afforded the tenant depends on the nature of the breach or other event triggering the right of irritancy. In particular, the proposed statutory scheme makes an important distinction between remediable and non-remediable breach. This differs from the 1985 Act which turns on the distinction between monetary and non-monetary breach.

1.36 **Remediable breach.** We believe that the primary function of an irritancy clause is to act as a compulsitor to performance.⁶² Therefore, in cases of remediable breach, we propose that the landlord should not be able to serve a notice of termination unless he has first served a warning notice on the tenant giving him an adequate opportunity to remedy the breach and that period has expired without the breach being remedied. This extends the approach of the 1985 Act in respect of monetary breach to all cases of remediable breach. We have also taken the opportunity to improve certain aspects of the notice procedure so as to give the tenant a clearer picture of what is expected of him and the consequences of failing to comply with the requirements of the warning notice.

1.37 We propose that the time allowed in the warning notice to remedy the breach should be not less than 28 days. Accordingly, in relation to a monetary breach, the current minimum period of 14 days will be extended to 28 days: this is because we think that 14 days may be too short when weekends and holiday periods are taken into account. While the time period for monetary obligations remains strict, in cases of non-monetary breach we believe that the tenant must be given a reasonable opportunity to perform. If the period allowed in the notice is unreasonably short, the period should be capable of being extended by application to the relevant court. The question before the court is the objective consideration of what is a reasonable period for compliance. Limiting the scope of the court's enquiry in this way, will minimise the length and expense of litigation. In the interests of fairness, the courts are given a further discretionary power to allow a tenant who has substantially completed the work more time in order to finish it.

1.38 **Insolvency events.** Where the irritancy is triggered by an insolvency event affecting the tenant, we accept that the landlord should not be able to frustrate the realisation of a valuable asset by exercising a right of irritancy. Therefore where the lease is assignable, we propose that the landlord should not be able to serve a notice of termination unless he has

⁶¹ See draft Bill, s 19(1).

⁶² See paras 2.12ff below.

first served a moratorium notice. The moratorium notice will offer the insolvency practitioner responsible for the administration of the insolvency an opportunity (of at least 6 months) to assign the lease. Only if the offer is not accepted or the lease is not assigned within this period will the landlord then be entitled to serve a notice of termination. This is without prejudice to the landlord's right to irritate the lease on another ground, for example non-payment of rent, during the moratorium period.

1.39 **Non-remediable events.** Where the breach or event triggering the right of irritancy is non-remediable, the tenant cannot be compelled to perform. However, the underlying policy considerations of fairness and effectiveness are the same.

1.40 In such cases, and in cases where irritancy is triggered by the occurrence of an event other than an insolvency event affecting the tenant under an assignable lease, we believe that irritancy should be permitted except where it would be clearly out of proportion to the breach or event in question. We therefore propose that the court should be given a statutory discretionary power to prevent or delay the exercise of irritancy where it considers that the termination of the lease would be a manifestly excessive response to the breach or other event.

1.41 We also recommend the abolition of the common law and statutory legal irritancies and their replacement with a uniform statutory irritancy for non-payment of 6 months' rent which is subject to the controls on irritancy for remediable breach. We also propose the abolition of the general equitable power of relief from the operation of irritancy which we have found to be virtually obsolete.

Structure of the report

1.42 Part 2 of the report sets out the policy considerations which we have followed in formulating our recommendations for reform. In Part 3 we set out our recommendations for reform in detail. Part 4 considers whether our recommendations may be implemented in an Act of the Scottish Parliament. Part 5 lists our recommendations. A draft Bill to give effect to our recommendations is contained in Appendix A. Appendix B lists the members of our advisory panels of commercial property practitioners and insolvency practitioners. Appendix C lists the persons and organisations who submitted comments on the discussion paper. Appendix D reprints the results of a survey of commercial property interests first published in the discussion paper. Appendix E lists those who took part in the survey.

Legislative competence

1.43 For the reasons set out in Part 4 we consider that the content of the draft Bill is within the legislative competence of the Scottish Parliament.

Acknowledgements

1.44 We wish to record our thanks and appreciation to the members of our two advisory panels and to our agricultural law consultant Alasdair Fox, WS for their helpful advice and assistance. We are also grateful to Ian Davis and John Glover of Registers of Scotland for their advice on the implications of our recommendations for the operation of the Land Register.

Part 2 Factors Influencing Reform

Introduction

2.1 In this Part we set out the major policy considerations which have influenced our recommendations for reform. In the law of irritancy there are a number of conflicting principles which require to be balanced.

Freedom of contract

2.2 Conventional rights of irritancy are a contractually agreed remedy and it is a fundamental principle of Scots contract law that parties should be held to the terms of their bargain.¹ Where the parties do not have equal bargaining power and the terms of a contract give the stronger party a significant advantage over the weaker, legislation may intervene to prevent cases of obvious inequity.² However, in many commercial leases the economic weight and respective bargaining powers of the parties are more or less balanced. Even a landlord in a strong bargaining position may be constrained from imposing a penal irritancy clause because of the depressing effect this may have on the level of rent that may be fixed at subsequent rent reviews.

2.3 This is not usually the case in agricultural leases where landlords are often in a superior bargaining position because of the shortage of agricultural land which is available for letting. Accordingly, some agricultural tenants will almost certainly have been forced into accepting a comprehensive irritancy clause with little chance to modify its terms. The new tenancies introduced by the 2003 Act³ are intended to encourage landlords to let agricultural land on fixed term tenancies, on terms which reflect a more even balance between the parties' respective interests. It remains to be seen whether this balance will be reflected in the provisions for irritancy which these leases contain.⁴

Effectiveness of irritancy as a remedy

2.4 Some concern was expressed by the House of Lords in the *Dollar Land* case that the present law of irritancy could have a detrimental effect on financial investment in commercial property in Scotland. In the discussion paper, we expressed the view that these fears were ill-founded.⁵

2.5 Our preliminary conclusion was unanimously supported by consultees. Indeed, it was suggested to us that the current law acts as an incentive to investment due to the

¹ *Stair Inst* 1, 10, 14; *Erskine Inst* III, 34; *Fairie v Inglis* (1669) Mor 14231. See generally J Thomson "Judicial Control of Unfair Contract Terms" in *A History of Private Law in Scotland* (K G C Reid and R Zimmermann eds) (2000) Vol II p 157.

² See eg in relation to exemption clauses, the Unfair Contract Terms Act 1977; Unfair Terms in Consumer Contracts Regulations 1999 (SI 1999/2083).

³ See para 1.18 above.

⁴ The parties are free to make such provision as to irritancy as they wish; 2003 Act, s 18(1) but see paras 1.21ff above.

⁵ See the discussion paper, paras 3.33ff. See also the results of our survey in Appendix D.

effectiveness of irritancy as a remedy. It allows leases to be terminated quickly and cleanly and is enforced by the courts in a consistent way. Thus the parties concerned are able to arrange their commercial affairs with greater certainty. This is particularly important for commercial investment in property which is based to a large extent on the parties' assessment of the risks involved in the project at the date when the contract is made.

2.6 With regard to agricultural leases, it has been argued that due to the extensive security of tenure provisions tenants enjoy under the 1991 Act,⁶ agricultural landlords greatly value an effective conventional irritancy clause as a means of recovering vacant possession. Consequently, any weakening of the remedy may restrict further the supply of land available for letting under such tenancies. However, the same should not be true under LDTs and SLDTs where there is no security of tenure beyond the expiry of the initial period of the lease.

2.7 We therefore recognise the value of irritancy as a clean and effective remedy for breach of contract and believe that this is an important feature of Scots leasing law which should be retained.

Fairness

2.8 It was generally accepted by consultees that the enforcement of an irritancy clause can sometimes lead to harsh results which appear to be disproportionate to the harm sustained by the landlord as a consequence of the tenant's breach or other event triggering the right of irritancy.⁷

2.9 Irritating a 1991 Act tenancy is even more likely to lead to harsh and disproportionate results. Although tenants under such leases enjoy security of tenure, the landlord's right to irritate is preserved. Thus a conventional irritancy clause in such a lease is a very powerful weapon in the hands of the landlord. The evidence we have gathered as well as that submitted to the Scottish Parliament during the passage of the 2003 Act suggest that such clauses have become a recognised means by which the landlord can recover possession of the holding and thus circumvent the security of tenure provisions.

2.10 The problem is exacerbated by the fact that the statutory protection from the operation of conventional irritancies afforded to tenants of commercial leases under the 1985 Act does not extend to agricultural tenants. Accordingly, the tenant need not be given notice of the landlord's intention to exercise his right of irritancy nor an opportunity to remedy the breach. In addition, the farmhouse is often the home of the tenant and his family as well as his livelihood and is perhaps more likely to have been the subject of investment by him.

2.11 Therefore, although it is important that any reform to the law of irritancy does not nullify the effectiveness of the remedy, it must also reflect appropriate considerations of fairness.

⁶ See para 1.19 above.

⁷ See paras 4.8ff of the discussion paper. This is particularly true of development leases where the landlord often enjoys a substantial windfall benefit as a consequence of irritating the lease and regaining possession of the subjects together with the tenant's improvements. The main example is *Dollar Land*, see paras 1.8ff above.

Compulsitor for performance

2.12 We take the view that the primary function of an irritancy clause is to act as a compulsitor for performance of the tenant's obligations. Therefore before the landlord can exercise the right to terminate the lease, the tenant should be given appropriate notice of the threatened use of irritancy and a suitable opportunity to remedy the breach.

2.13 **Monetary breach.** In relation to monetary breach, section 4 of the 1985 Act already prescribes that the landlord cannot exercise a right to irritate without first giving the tenant at least the statutory minimum period of notice of his intention to do so. This gives the tenant time to purge the breach. Nevertheless, problem cases still occur.⁸ We believe that there are aspects of the notice procedure that could be improved so as to give the tenant a clearer understanding of what is expected of him and the consequences of a failure to comply with the requirements of the notice. Such changes would enhance the role of irritancy as a compulsitor for performance.

2.14 **Non-monetary breach.** As we have shown,⁹ the application of the fair and reasonable landlord test in section 5 of the 1985 Act has proved problematic. As a result, it appears that landlords rarely irritate for non-monetary breach and therefore irritancy fails to secure performance of such obligations. In our view, the present situation is therefore unsatisfactory.

2.15 **Breach which cannot be remedied.** Where the tenant's breach is not capable of remedy, clearly the tenant cannot be compelled to do so by the threat of irritancy. In such cases, an irritancy clause can no longer function as a compulsitor for performance. Accordingly, the remaining considerations to be balanced are the landlord's need for an effective means of removing an unsatisfactory tenant and the tenant's interest in the remedy operating fairly and in proportion to the breach. The law needs to be flexible enough to take into account the nature of the breach and the consequences of irritancy for both parties.

2.16 In the case of a continuing breach that cannot be remedied for the past, threat of irritancy can secure that the tenant ceases to breach the terms of the lease for the future. Therefore such circumstances should not be treated as cases of non-remediable breach but as cases where the behaviour complained of can be remedied albeit only in relation to the remainder of the term. Other remedies, such as an action for damages, can be used to recover losses incurred during the period of non-compliance.

2.17 **Insolvency event affecting the tenant.** As discussed in Part 1,¹⁰ conventional irritancy clauses commonly allow the landlord to irritate the lease on the occurrence of an insolvency event affecting the tenant. Following such a change there is often a period of uncertainty during which the landlord holds a right to irritate the lease immediately and without warning.¹¹ During that period the insolvency practitioner may be attempting to realise the tenant's assets, including his interest under the lease. Circumstances may occur

⁸ In *Dollar Land* the terms of s 4 were complied with.

⁹ See paras 1.11ff above.

¹⁰ See paras 1.1 and 1.12 above.

¹¹ Subject at present to challenge under s 5 of the 1985 Act for commercial leases or under the common law equitable power of relief. However, as we have shown in Pt 1, it is only in cases where the tenant's interest under the lease is of sufficient value that a challenge to the irritancy notice under s 5 will be considered economically viable.

in which he is making progress with a disposal only for the lease to be terminated abruptly by an irritancy notice.

2.18 This position acts against the interests of the tenant's creditors. It gives the landlord an advantage over other creditors, whether secured, preferential or otherwise, although the landlord may only rank as an ordinary creditor himself. Indeed, the right to irritate can arise when the landlord is not a creditor of the tenant at all. The recent reform of insolvency law referred to in Part 1 aims to suspend the landlord's advantage while the company is in the process of trying to reach a settlement for the benefit of all creditors. The reforms introduce a restriction on the exercise of the landlord's right of irritancy in certain circumstances,¹² regardless of the trigger which gives rise to the right, ie whether the irritancy results from a tenant's breach or a change in financial status. We recognise that this policy objective would be frustrated where the landlord holds an immediate right of irritancy in such circumstances.

2.19 One of the main differences between agricultural leases and commercial leases is that 1991 Act tenancies are generally not assignable due to the element of *delectus personae* in the contract. However, section 10A of the 1991 Act¹³ when commenced will provide for limited rights of assignation to family members who stand to inherit the tenant's interest in a 1991 Act tenancy on the tenant's death. Section 7 of the 2003 Act also expressly permits the assignation of LDTs with the consent of the landlord.¹⁴ Therefore where such leases are assignable, similar considerations will now apply to insolvent agricultural tenants.¹⁵

2.20 On the other hand, the interests of the landlord as owner of the property require to be protected. He has an obvious interest in maintaining the asset and in ensuring that his tenant has an institutionally acceptable covenant. Again a balance between these two factors requires to be reached.

Compensation for windfall benefits

2.21 When a lease has been terminated, the landlord may benefit from any improvements to, or development of, the subjects made at the expense of the tenant. As noted above,¹⁶ the House of Lords has held that the value of any improvements or development cannot be recovered by the tenant under the law of unjustified enrichment since the landlord has been enriched as a consequence of a contractually agreed remedy and consequently the enrichment is not unjustified.¹⁷ Nevertheless concern was expressed that the gain of such benefits to the landlord could be quite disproportionate to the loss he has suffered as a

¹² Ie where the tenant company goes into administration or enters negotiations over company voluntary arrangements.

¹³ To be inserted by s 66 of the 2003 Act.

¹⁴ The landlord may withhold consent if there are reasonable grounds for doing so; and, in particular, if not satisfied that the proposed assignee would have the ability to pay the rent or be in a position to maintain the land adequately or have sufficient skills or experience to manage and maintain the land in accordance with the rules of good husbandry; s 7(3) of the 2003 Act. Additionally, as an alternative to consenting to assignation, the landlord is to be given the right to acquire the tenant's interest in the tenancy; s 7(5).

¹⁵ In practice, we are led to believe that as the insolvency of the tenant is normally irremediable, the likely situation is for both parties to wish to terminate the lease as quickly as possible. This enables the landlord to relet the land speedily so as not to cause lasting damage to its agricultural value. It also enables the insolvency practitioner to receive any compensation on quitting the holding, eg for improvements, which is the true value of such leases to be realised for the benefit of creditors.

¹⁶ Para 1.10 above.

¹⁷ *Dollar Land (Cumbernauld) Ltd v CIN Properties Ltd* 1998 SC (HL) 90.

consequence of the breach and that the potentially serious economic consequences for the tenant of the enforcement of an irritancy clause might have a detrimental effect on investment in commercial property in Scotland. These concerns in part led to the current review.

2.22 It appears to be a fundamental principle of the law of unjustified enrichment that benefits obtained as a consequence of the valid exercise of a legal remedy are not held without cause and therefore their value cannot be recovered in a claim for recompense. Given that the current law on unjustified enrichment is in a critical state of judicial development, we feel that to make an exception to the general rule of non-recovery for benefits lawfully obtained for enrichment as a consequence of the exercise by a landlord of a contractually agreed right to terminate a lease, would be premature and could inhibit the principled development of the law. In these circumstances, we have decided to make no recommendation in respect of compensation for a tenant in respect of the value of benefits lost as a consequence of the landlord's exercise of his option to terminate a lease.

Conclusion

2.23 In formulating our recommendations for reform our primary objective was to provide that irritancy is used in a way which seeks to ensure that the tenant performs his obligations under the lease. The procedure by which the remedy operates must also balance fairness to both the tenant and the landlord. In so doing we have taken into account the views of our consultees who were keen to preserve the parties' freedom of contract where possible and considered irritancy to be an effective remedy for non-performance. We also had in mind that while there was 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 was not supported by commercial property investors or legal practitioners.¹⁸

2.24 The general principles outlined above can be applied equally to agricultural leases. The 2003 Act did not attempt a complete review of the operation of the law of irritancy on such tenancies. The legislative changes to the law of irritancy incorporated in the Act were a response to individual issues of concern which emerged from the Scottish Executive's consultation with landlord and tenant interest groups. The Executive recognised that further changes to the law of irritancy should await the outcome of our more extensive review.¹⁹ We have therefore concluded that the same general principles should be applied when considering our proposals for reform of the law of irritancy of agricultural leases.

¹⁸ Para 4.12 of the discussion paper.

¹⁹ See para 1.21 above.

Part 3 Recommendations for Reform

Introduction

3.1 As stated above,¹ we do not think that there is a case for root and branch reform of the law of irritancy. Nevertheless, the current law is not without its difficulties. There is a need for a clear and comprehensive set of rules to control the way in which a landlord may terminate a lease as a consequence of a right to irritate: these must be fair while at the same time avoiding complex and expensive litigation. The opportunity should also be taken to remove those aspects of the law which have become archaic or have caused difficulty.

Irritancy and the general law of contract

3.2 An irritancy is a consensual remedy. In essence, the parties agree that it is a term of the lease that if a particular event occurs the landlord will have an option to terminate the lease.² In the case of a legal irritancy, the term is implied by law: in that of a conventional irritancy, the term is express. While the right to irritate arises from the terms of the lease, express or implied, it 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). While the event triggering the landlord's option to terminate will often constitute a breach of a term of the lease, that is not invariably so as, for example, where the option is triggered by an insolvency event affecting the tenant. The point is that the right to irritate a lease is dependent on the purification of a condition stipulated in the lease, for example the appointment of a receiver or the tenant's failure to pay the rent on time.

3.3 The option to irritate is similar to the right of rescission, ie the right of the innocent 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 breach. Consequently, the innocent party can sue for damages in respect of breaches which arose before the contract was rescinded. In other words, rescission after material breach only terminates the contract in so far as there are obligations which remain to be performed. By contrast, irritancy clauses 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 never existed, ie to terminate the lease with retrospective effect.³ But if the effect of irritancy is to terminate the lease retrospectively then, in theory at least, the landlord should not be able to sue in respect of any breach which took place before the lease was terminated. Since the lease is retrospectively null, there has been no term which the tenant could have broken. To avoid this result it has become standard practice for irritancy clauses to stipulate that the landlord reserves the right to exercise all competent remedies in relation to breaches occurring before the lease is irritated. In the absence of such express

¹ Para 2.23 above.

² As this description of the remedy is more readily understandable to the lay reader, the draft Bill and often this report uses the phrase 'option to terminate' rather than the technical legal term irritancy.

³ Eg the irritancy clause may provide that the lease is to become null and void.

reservation, the right to sue for damages for breach would be lost when the lease was irritated.⁴

3.4 Yet it is difficult to understand how these reservation clauses operate if the effect of irritancy is indeed to terminate the lease retrospectively; arguably the retrospective annulment of the lease would render even the reservation clause null. We think that the law should be clarified. The analogy between a right to irritate and the right to rescind after a material breach of contract is strong. Moreover, landlords already use reservation clauses to enable them to sue for damages for breach of the lease, albeit that irritancy is supposed to have retrospective effect. Therefore we consider that the effect of termination after irritancy and termination after rescission for material breach should be the same. In both cases, it should only terminate the obligations of landlord and tenant for the future and should not affect the rights and liabilities that have accrued up to the time of termination. Nor should the termination affect any provisions in the lease on such matters as arbitration, compensation or quantification of damages which were intended either expressly or impliedly to survive the termination of the contract.

3.5 We recommend that:-

1. (a) **The effect of the exercise of an option to terminate a lease (ie an irritancy) should be to terminate the lease for the future except any provisions as to arbitration, compensation or quantification of damages or any other provisions intended to survive termination.**
- (b) **The termination of the lease should not affect any rights or liabilities that have already accrued before the termination of the lease takes effect.**

(Draft Bill, section 14)

3.6 Conversely, where the option to terminate is triggered by a breach of the lease, we recognise that, as under the current law,⁵ it is crucial that a landlord should not be able to avoid the statutory controls over the exercise of that option by electing instead to rescind the lease on the ground that the breach was material.

3.7 Therefore we recommend that:-

2. **The controls over the exercise of an option to terminate a lease (ie an irritancy) should apply to any power conferred on a landlord by any enactment or rule of law including a power arising under the general law of contract to rescind a lease as a consequence of a tenant's material breach of contract.**

(Draft Bill, section 1(2))

3.8 Where a landlord purports to irritate a lease, several defences may be open to the tenant. In particular, the tenant may dispute whether or not the condition enabling the

⁴ *HMV Fields Properties Ltd v Skirt 'n' Slack Centre of London Ltd* 1987 SLT 2, *Glasgow City Council v Morrison Developments Ltd* 2003 SLT 263.

⁵ Law Reform (Miscellaneous Provisions) (Scotland) Act 1985, s 6(1).

landlord to exercise his right has in fact been purified. If it has not, the lease cannot be terminated. Again, where the landlord purports to rescind a lease, the tenant can argue that the breach was not in fact material: if he succeeds, rescission is ineffective and the lease is not terminated. Moreover, since the option to terminate is for the benefit of the landlord only, he can determine whether or not it should be exercised. If the landlord has by his conduct led the tenant to believe that he will not irritate the lease he will be personally barred from terminating the lease: this does not, however, 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. Whether the actings of the landlord amount to waiver of the right to terminate the lease is essentially a question of fact to be determined objectively.⁶

3.9 The controls that we recommend give protection to a tenant whose landlord is purporting to irritate his lease. But they are intended to be additional to the substantive defences described above: these should therefore be available to the tenant at every stage of the irritancy proceedings including any subsequent action for removing.

3.10 Accordingly we recommend that:-

3. (a) **Nothing in the recommendations should prevent a tenant from relying on any defence, exception or ground for relief which is not specifically recommended to be abolished.**

(Draft Bill, section 18(1)(c))

- (b) **Any such defence or exception or ground for relief should be capable of being used by the tenant to challenge the purported exercise of the irritancy at any stage in the proceedings.**

(Draft Bill, section 13(1) and (3))

The common law equitable power of relief

3.11 As has been seen,⁷ the enforcement of an irritancy clause is subject to the court's common law equitable power to grant relief in cases of abuse or oppressive use of the remedy. This power is so narrowly construed by the courts⁸ that it is difficult to envisage circumstances in modern practice where it would be invoked successfully. A large majority of the consultees agreed.

3.12 We therefore recommend that:-

4. **Any rule of law giving the Court of Session or any other court an equitable power to grant relief to a tenant against the oppressive operation of irritancy should be abolished.**

(Draft Bill, section 16(1))

⁶ *HMV Fields Properties Ltd v Bracken Self Selection Fabrics Ltd* 1991 SLT 31 at p 35.

⁷ Para 1.17 above.

⁸ *Dorchester Studios (Glasgow) Ltd v Stone* 1975 SC (HL) 56, *CIN Properties Ltd v Dollar Land (Cumbernauld) Ltd* 1992 SC (HL) 104.

Legal irritancies

3.13 As noted above,⁹ there are three legal irritancies. The first is triggered by non-payment of rent for a continuous period of two years.¹⁰ The other two only apply to agricultural leases. The right to irritate under the Act of Sederunt for non-payment of a year's rent or where the tenant has abandoned the holding,¹¹ has in practice been overtaken by the right to remove the tenant under the Agricultural Holdings (Scotland) Acts for non-payment of six months' rent.¹² In all three cases, the irritancy can be purged by payment of the arrears before decree of declarator has been extracted.

3.14 In the discussion paper we asked consultees whether these legal irritancies should be abolished.¹³ There was general agreement that the legal irritancy of non-payment of two years' rent was rarely used. However, some concern was expressed about the effectiveness of other remedies which might be available to a landlord in the unlikely event that a lease did not contain a conventional irritancy clause. There was less consensus in respect of the agricultural irritancies. Many agricultural leases remain unwritten and do not therefore contain conventional irritancy clauses. Moreover, many agricultural tenants have security of tenure. There was therefore less support for the removal of a means by which the continuing tenancy can be brought to an end.

3.15 We take the view that there is a case for a "long stop" irritancy to accommodate leases which are not in writing or which, while in writing, do not contain a conventional clause entitling the landlord to irritate for non-payment of rent. However, the present legal irritancies are little used as the period of non-payment required to trigger the option to terminate is too long and the process may be drawn out given that the tenant may purge the irritancy at any point before decree. We believe that one standard form of legal irritancy should be available, which should also reflect the wider policy objectives of our proposals for reform. Since most of the leases upon which this legal irritancy will impact are agricultural leases, we propose to adopt the policy of the Agricultural Holdings (Scotland) Acts and allow a landlord the option to terminate a lease if six months' rent is due and unpaid. The exercise of this option to terminate will be subject to the statutory controls which we recommend in relation to the exercise of a conventional irritancy for non-payment of rent. In other words, the tenant will have the opportunity to remedy the breach during the period allowed in the warning notice: however, once that period has expired the irritancy can no longer be purged.¹⁴ On the other hand, there is no reason why the statutory option to terminate should be compulsory and so we consider that a landlord should be able to "contract out" of this right should he wish to do so. This could be done by a stipulation in the lease that the statutory option to terminate should not be applicable. Accordingly we recommend that:-

5. (a) **The common law legal irritancy of non-payment of two years' rent should be abolished.**

(Draft Bill, section 16(2))

⁹ Paras 1.15-1.16 above.

¹⁰ It has been abolished in relation to certain long leases: see Leasehold Casualties (Scotland) Act 2001, s 6(1).

¹¹ Codifying Act of Sederunt, 14 June 1913, s 5 of ch XV of Book L.

¹² Agricultural Holdings (Scotland) Act 1991, s 20.

¹³ Paras 3.1-3.3 and para 6.6.

¹⁴ See paras 3.30ff below.

(b) The legal irritancies in respect of agricultural leases should be abolished.

(Draft Bill, section 21 and schedule 2)

(c) The legal irritancies should be replaced with an option to terminate the lease for non-payment of six months' rent.

(Draft Bill, section 15)

(d) That option to terminate the lease should be subject to the same controls as a conventional irritancy for non-payment of rent.

(Draft Bill, section 1(2))

(e) The landlord and tenant should be entitled to contract out of the statutory option to terminate.

(Draft Bill, sections 15 and 17(1))

The current statutory control of irritancy

3.16 As we have explained,¹⁵ the current statutory controls over irritancy clauses in commercial leases are to be found in sections 4 to 7 of the 1985 Act. The difficulties experienced with these provisions have also been articulated.¹⁶ In our view the opportunity should be taken to repeal these provisions and replace them with a comprehensive set of statutory controls over the termination of all leases as a consequence of the exercise of an irritancy.¹⁷ We therefore recommend that:-

6. The existing statutory controls on the exercise of an irritancy contained in the Law Reform (Miscellaneous Provisions) (Scotland) Act 1985 should be abolished.

(Draft Bill, section 21 and schedule 2)

The scope of the recommended controls

3.17 The controls in the 1985 Act were restricted to irritancies in commercial leases. It appears that residential leases and agricultural leases were excluded on the grounds that tenants were sufficiently protected under legislation governing agricultural holdings and residential tenancies respectively. In the discussion paper we doubted whether it was necessary or appropriate to extend our review to residential leases.¹⁸ On further reflection, however, we have changed our view. As we noted in the discussion paper not all residential leases may fall within the protection of the Rent Acts or Housing Acts.¹⁹ Moreover, the statutory protection may be removed at some future date, leaving residential tenants more vulnerable to irritancy than at present. We also intend to extend the statutory control of

¹⁵ Paras 1.4ff above.

¹⁶ Ibid especially at paras 1.11-1.14 in relation to s 5.

¹⁷ Or rescission of the lease as a consequence of a material breach: see paras 3.6-3.7 above.

¹⁸ Discussion paper, paras 1.10-1.14.

¹⁹ Ibid, para 1.13.

irritancy to agricultural leases: the subjects of such tenancies are often used by the tenant for residential as well as agricultural purposes. Therefore, to the extent that irritancy is a remedy which may be used in relation to residential leases, we now take the view that as a matter of principle the controls which we recommend should apply to the exercise of irritancy in such cases. However, it is a fundamental tenet of our policy that the security of tenure or protection against eviction that a tenant enjoys under current legislation should not be lessened. Therefore our proposals should be without prejudice to these existing controls. This has meant that on occasions we have had to recommend specific provision for agricultural leases.

3.18 Accordingly we recommend that:-

7. (a) **The statutory controls on the exercise of irritancy should apply to all leases of land.**

(Draft Bill, section 19(1))

- (b) **Nothing in those proposed controls should enable a lease to be terminated where it could not otherwise be terminated.**

(Draft Bill, section 18(1)(a))

Notice of termination

3.19 The fundamental principle which underlies our suggested reforms is that where a landlord has an option to terminate a lease on a breach by the tenant or some other event, that option may not be exercised except by service of a notice in statutory form stating that the lease is to be terminated. In this way landlords would be required to give the tenant clear notice of the grounds on which the termination is based and information as to the steps that can be taken to challenge the basis of the notice. Clauses which purported to provide that the lease should come to an end "automatically" would no longer be capable of doing so. An option to terminate includes a traditional irritancy clause, ie an express or implied²⁰ right to terminate a lease on a breach or the occurrence of another event. Also covered is a landlord's right under the general law of contract to rescind a lease after a material breach.²¹

3.20 The essence of an irritancy is that the landlord has the right to bring the lease to an end prematurely, ie before the term of the lease has expired. Accordingly, in our opinion the natural expiry of the lease should not be considered as an event which triggers an option to terminate and should therefore not be subject to the proposed statutory controls. Similarly, we think that parties should also be able to continue to have a break in their lease, ie a provision that the lease will come to an end on a particular date before the natural expiry of the lease. This may be done in order to allow the terms of the lease to be renegotiated, in particular to allow a rent review. We do not think that such clauses should be subject to our proposed controls as in these circumstances the terms of the parties' agreement is being fully implemented by the termination of the lease.

²⁰ Ie for non-payment of six months' rent. See paras 3.13ff above and recommendation 5.

²¹ See para 3.6 above and recommendation 2.

3.21 Therefore we recommend that:-

8. (a) **An option to terminate a lease on a breach by the tenant or on the occurrence of any other event should only be exercised by the landlord serving a notice of termination on the tenant.**

(Draft Bill, section 1(1))

- (b) **For this purpose an option to terminate includes a right expressly conferred on the landlord under the lease, the statutory option to terminate for non-payment of six months' rent and the common law right to rescind a lease for material breach.**

(Draft Bill, section 1(2))

- (c) **To the extent that any term in a lease provides that the lease will come to an end automatically or is to be null and void or is to be irritated or subject to irritancy on a breach by the tenant or the occurrence of any other event that term should have effect as though it were a provision giving the landlord an option to terminate the lease.**

(Draft Bill, section 1(3))

- (d) **The occurrence of an event in this context does not include the arrival of the ish or a break in the lease.**

(Draft Bill, section 1(4))

Notices of termination and the Land Register

3.22 The irritancy of a lease registered in the Land Register must be given effect in the Register. The Keeper currently requires a declarator of irritancy before the title sheet for the tenant's interest can be cancelled.²² We consulted Registers of Scotland on the possible effect of the introduction of a system of irritancy based on notices of termination which in most cases will remove the need for a declarator. Under section 4(1) of the Land Registration (Scotland) Act 1979 the Keeper has a discretion to determine the type and quality of evidence which supports a registration application. The Registers concluded that it would remain a risk management issue for the Keeper to consider the level of evidence he will require in each case before cancelling a tenant's title sheet following apparent termination by the landlord. In most cases, by examination of the notices and factual information supplied by the landlord, the Keeper will be able to conclude that termination has taken place beyond any realistic possibility of challenge without the need to see a declarator. We therefore conclude that the interaction of our proposals with the operation of the system of land registration should work satisfactorily in practice.

²² I Davis and A Rennie (eds), *Registration of Title Practice Book* (2nd ed) (2000) at para 5.55.

When can a notice of termination be served?

3.23 The notice of termination is formal notice that the lease is to terminate on a particular date. Since irritancy is a remedy which has the effect of extinguishing the tenant's property right, we propose that tenants should be protected against the use of the remedy through statutory control of the conditions precedent to the service of such a notice. What controls are appropriate depend on the type of breach or kind of event which has triggered the landlord's option to terminate the lease. We think that there are three different situations which should be recognised:-

- (a) where the option to terminate has been triggered by a breach which can be remedied by the tenant, ie a remediable breach;
- (b) where the option to terminate has been triggered by an insolvency event affecting the tenant of an assignable lease; and
- (c) where the option to terminate has been triggered either by a breach which cannot be remedied or by any other type of event.

Remediable breach in general

3.24 We have taken the view²³ that the primary function of an irritancy clause is to act as a compulsitor for the performance of the tenant's obligations under the lease. It follows that, before a notice of termination can be served, the tenant must be given notice of the landlord's intention to terminate the lease unless the tenant performs his obligations. This is to be known as a warning notice. Because of its importance for the tenant, a warning notice should be in writing. Moreover, the period allowed in the warning notice should be of sufficient length to enable the tenant to perform the obligations. The notice should also warn of the serious consequences for the tenant if he does not perform and the landlord elects to terminate the lease by serving a notice of termination. Giving the tenant such notice and a period during which he can remedy the breach appear to us to accord with elementary principles of fairness which must underpin the exercise of a remedy which can have potentially drastic consequences for a recalcitrant tenant. It could be argued that it is unfair to landlords to have to allow a tenant, who may have been in default for a long time, a further period within which to perform before the remedy may be exercised. However, irritancy has the effect of extinguishing a property right as well as terminating a contract and therefore should be strictly and fairly regulated. Moreover, our recommendations contain an element of counterbalance which should prevent abusive manipulation of the statutory protections by tenants.

3.25 Accordingly we recommend that:-

9. **A landlord should not be permitted to serve a notice of termination based on a remediable breach unless the tenant has failed to remedy the breach after having been given a written warning of the landlord's intention to terminate the lease and an opportunity to remedy the breach.**

(Draft Bill, section 2(1))

²³ Para 2.12 above.

3.26 A remediable breach should be defined widely. It would include a breach of a monetary obligation and a breach of any obligation which is in fact capable of being remedied. Moreover, a breach should be regarded as remediable even if the time by which the obligation should have been performed has passed. Thus for example, if it was a term of the lease that repairs had to be completed by a particular date, this would be treated as a remediable breach even though the date for completion had expired. In the case of a continuing breach which can be remedied for the future, the breach does not cease to be remediable merely because there has been a period during which it has already occurred and therefore can no longer be remedied in respect of that period.²⁴

3.27 We therefore recommend that:-

10. **A remediable breach should include both the breach of an obligation that should have been performed by a date that has passed and a continuing breach which can be remedied for the future.**

(Draft Bill, section 19(2))

3.28 When asked what would be a fair period within which a breach should be remedied, consultees considered that a distinction should be drawn between the breach of monetary and non-monetary obligations. We agree. The tenant's failure to comply with a monetary obligation causes an immediate and palpable loss to the landlord. Payment of rent is the most obvious example of a tenant's monetary obligations and is his primary obligation under the lease. It represents the landlord's return for parting with vacant possession of his property. However, the same is not true of non-monetary obligations. While the tenant might be obliged to redecorate the premises every five years, being 12 months late in doing so may not cause the landlord an immediate or demonstrable loss.

3.29 Accordingly, it seems necessary to differentiate between monetary and non-monetary remediable obligations. Breach of a monetary obligation has such a significant impact on the landlord that the exercise of irritancy should operate strictly. On the other hand, the breach of a non-monetary obligation does not have such an impact. Provided that rent is being paid, the landlord is receiving the primary consideration for which he was prepared to grant vacant possession of his property, even if the tenant is in breach of another, non-monetary obligation. Any loss which the landlord sustains on account of the tenant's non-monetary breach of contract can be recovered through the alternative remedy of damages. Therefore, we are of the view that in cases of non-monetary breach the balance of fairness dictates that the tenant should be given a reasonable opportunity to remedy the breach before the lease is terminated and vacant possession of the property returned to the landlord.

Monetary breach

3.30 Under section 4 of the 1985 Act, the tenant has a minimum period of fourteen days in which to remedy a monetary breach. We continue to believe that there should be a set minimum period for compliance with all monetary obligations but we think that this period

²⁴ Eg a failure to observe a prohibition in the lease on displaying articles for sale outside the premises cannot be remedied in relation to an earlier period but may be observed for the future.

is too short. In particular, when account is taken of weekends and holiday periods,²⁵ it may be insufficient to enable the tenant to investigate the circumstances of the breach and raise the necessary funds. Instead, a period of 28 days was considered reasonable by a majority of the consultees who addressed this question. Accordingly, we consider that there should be a warning notice allowing a period of not less than 28 days during which the tenant can remedy the breach by paying the money that is due and outstanding. If the lease provides for a longer period in which to pay, then the tenant should have the longer period. Moreover, at any time prior to the date of service of the notice of termination, the parties should be able to agree to extend the time allowed in the warning notice for the tenant to pay.

3.31 Therefore we recommend that:-

11. (a) **The time that a landlord requires to give a tenant to remedy a breach of a monetary obligation should not be less than 28 days or any longer period allowed for payment under the lease or otherwise.**

(Draft Bill, section 2(2))

- (b) **The time allowed in the warning notice to remedy the breach may be extended by agreement between the landlord and tenant at any time prior to the date of service of the notice of termination.**

(Draft Bill, section 3(1))

3.32 Consequently, when there has been a breach of a monetary obligation, if the landlord wishes to exercise an option to terminate the lease on this ground, he must serve a warning notice on the tenant allowing a minimum period of 28 days during which the tenant can remedy the breach by paying the sum due. If the breach is not remedied within the 28 days the landlord may then, and only then, serve a notice of termination which will take effect on a date specified in that notice ("the specified date"). This date cannot be earlier than the date of service of the notice of termination, but in our view it need not be later.²⁶ Provided the notice of termination is valid, the lease will be terminated on the specified date.²⁷ To give an example:-

T fails to pay rent. In the lease L has an option to terminate for breach of a monetary obligation. To exercise this option, L must issue a warning notice stating (i) that T has the minimum statutory period of 28 days to remedy the breach and (ii) that L will terminate the lease if T fails to do so. If T fails to pay by the end of the 28 day period, then and only then, does L become entitled to serve a notice of termination on T stipulating that the lease will be terminated on a date specified in the notice; this specified date can be no earlier than the date of service of the notice of termination.

²⁵ This was one of the issues in *CIN Properties Ltd v Dollar Land (Cumbernauld) Ltd* 1992 SC (HL) 104 where the notice demanding payment of the rent was served immediately before the Christmas holiday period began.

²⁶ For agricultural leases, see para 3.66 below.

²⁷ For further discussion, see paras 3.64ff below.

Non-monetary breach

3.33 Where the triggering event is a remediable breach of a non-monetary obligation, a landlord should likewise not be entitled to serve a notice of termination until he has served a warning notice on the tenant. However, unlike monetary breaches, the nature of and time required to remedy a non-monetary breach will vary considerably. Some breaches may be capable of being remedied almost instantaneously, for example, taking down prohibited signage. On the other hand, substantial building or repairing obligations may require a long period to complete, perhaps in some cases, several years.

3.34 We set out the case for distinguishing between monetary and non-monetary obligations above.²⁸ For the reasons discussed there, we believe that before a lease can be terminated for a remediable non-monetary breach, the tenant should be given a chance to fulfil his obligations. If he is to be able to do so, the time allowed must be reasonable in the circumstances. While initially the landlord would be entitled to specify what he considers to be a reasonable period in the warning notice, this would be subject to certain caveats in order to prevent improper use of the remedy.

3.35 Although there may be cases where remediable action can be taken immediately, nevertheless we consider that a tenant should always be given time properly to assess the implications of the notice and the extent of his obligations. We therefore propose that the minimum period allowed in the warning notice should be 28 days from the service of the notice or any longer period provided in the lease.

3.36 Where the tenant considers that the period specified in the warning notice is not reasonable there requires to be a mechanism for adjusting that period. The parties could do so by agreement and that should be permitted at any point prior to the landlord serving the notice of termination. There will, of course, be cases of dispute. In such cases the tenant should have the opportunity to challenge the notice period and such a challenge should have the effect of suspending the effect of the warning notice until the challenge is resolved. Nevertheless, we recognise that any mechanism for challenging the notice will be open to abuse. Tenants who are deliberately avoiding their obligations will use that mechanism tactically to delay the point at which the right to terminate may be exercised. We therefore take the view that the opportunity for challenge should be defined as strictly as possible to minimise such action, while allowing genuine cases where further time is appropriate to be given proper consideration by the court. We are also mindful of the criticisms which have been levelled at section 5 of the 1985 Act.²⁹ Applications to the court will inevitably result in delay. That being the case, we have attempted to focus the question before the court as narrowly as possible to minimise the extent of the evidence required and therefore the length and expense of litigation.

3.37 We therefore propose that a challenge to the notice period must be raised by application to the court within the period of 28 days after the service of the warning notice. By that time the tenant should have been able to obtain legal advice on the terms of the notice and assess whether the period allowed is reasonable. At this point, subject to one exception discussed below, the tenant bears the risk of supervening events subsequently rendering the period unreasonable. The tenant has, of course, assumed this risk in relation

²⁸ See paras 3.28-3.29 above.

²⁹ See paras 1.11-1.14 above.

to all his obligations on commencement of the lease. The question for the court is simply whether, having regard to the nature of the breach, the period allowed is unreasonably short. The matter would be determined objectively. The tenant is always to be given a fair opportunity to perform. Consequently, any other relative merits of the parties' positions or the effect of allowing the tenant to perform are irrelevant. Where the court extends the time, that period should be regarded as the time allowed by the warning notice.

3.38 Once a reasonable period for compliance has been fixed, the terms of the warning notice should operate strictly. There is one exception. A case could arise where the tenant has made substantial progress towards fulfilling his outstanding obligations, but cannot fully comply in the time allowed.²⁹ In assessing what was a reasonable period, the parties or the court could have omitted to consider a relevant factor or the tenant's ability to comply timeously may have been affected by a supervening event outwith his control. In such a case, to allow irritancy to operate strictly would be unduly punitive on a tenant who has genuinely tried to comply with his obligations. In these circumstances, we think that the tenant should be given a further opportunity to fulfil his obligations. Otherwise tenants might be deterred from incurring significant expenditure in order to fulfil their obligations, were they to lose their investment if the lease could be terminated because they narrowly failed to comply within the specified time. Unless such an exception is made, the proposed scheme could undermine the primary function of irritancy as a compulsitor for performance.

3.39 Therefore we propose that where the tenant has substantially performed the obligations specified in the warning notice but has been unable to complete performance, a further period of time may be granted on application to the court. Such an application should be made before the expiry of the notice period.

3.40 Our proposals require to be integrated with the existing regime for notices requiring the repair of fixed equipment in relation to leases of agricultural holdings. Under section 66 of the Agricultural Holdings (Scotland) Act 1991, the Land Court has power to modify a landlord's demand that the tenant remedy a breach of the lease in relation to fixed equipment. We do not intend that our proposals for reform of the law of irritancy should affect the Land Court's powers in this regard, save that the exercise of those powers should not operate to deprive the tenant of any protection against the operation of irritancy.

3.41 Accordingly we recommend that:-

12. (a) **The time that a landlord requires the tenant to remedy a non-monetary breach should not be less than 28 days or any longer period allowed to remedy the breach under the lease or otherwise.**

(Draft Bill, section 2(2))

- (b) **The time allowed in the warning notice to remedy the breach may be extended by agreement between the landlord and tenant at any time prior to the date of service of the notice of termination.**

(Draft Bill, section 3(1))

²⁹ Whether that time was specified in the warning notice or extended by agreement of the parties or on application to the court.

(c) At any time within the period of 28 days from the service of the warning notice the tenant should be entitled to seek an extension of the time allowed in the notice from the court on the ground that it is unreasonably short.

(d) At any time before the expiry of the time allowed in the warning notice, where the tenant has substantially performed the obligation in issue but requires a further period of time to complete performance, an extension of the time allowed may be obtained on application to the court.

(Draft Bill, section 3(2))

(e) Where the time allowed has been extended, any reference to the time allowed by the warning notice is a reference to the time as so extended.

(Draft Bill, section 3(3))

(f) The powers of the Land Court to modify a tenant's obligations in relation to fixed equipment under section 66 of the Agricultural Holdings (Scotland) Act 1991 should be available to modify the requirements of a warning notice served in respect of a breach of such obligations, but not so as to reduce the statutory minimum period.

(Draft Bill, section 4)

3.42 If the breach of the non-monetary obligation has not been remedied by the time allowed in the warning notice, then, and only then, should the landlord be able to serve a notice of termination. As in the case of a breach of a monetary obligation³⁰ the date upon which the notice takes effect should not be earlier than the date of service of the notice of termination on the tenant.³¹ Provided the notice of termination is valid, the lease will terminate on the specified date.

Insolvency events affecting the tenant

3.43 An insolvency event affecting the tenant can be an event which triggers a landlord's right to terminate the lease. It will be noticed that this need not involve any breach by the tenant of the terms of the lease. Although the power to irritate the lease in those circumstances could give the landlord an advantage over the tenant's creditors by removing one of the assets of the insolvency, it was clear on consultation that there was strong support for the retention of the ability to specify such an event as giving rise to a right of irritancy. However, it was recognised that it was desirable that there should be a period before the lease was terminated during which the lease, if assignable, could be assigned so as to realise the value in the lease for the benefit of the tenant's creditors. As noted above,³² this would be consistent with recent developments in the law of insolvency. In these circumstances, we take the view that a landlord should not be able to terminate a lease on the ground of a change in the tenant's financial status until the expiry of a period ("a moratorium") during

³⁰ Discussed at para 3.32 above.

³¹ For agricultural leases, see para 3.66 below.

³² Paras 1.24ff above.

which the insolvency practitioner charged with administering the tenant's assets³³ can attempt to assign the lease.

3.44 In order to identify the insolvency events affecting the tenant which commonly trigger a landlord's right to terminate the lease, we examined examples of irritancy clauses from commercial leases.³⁴ The terms of the clauses were very similar. In cases of corporate insolvency, the lease often specifies that the tenant's liquidation, administration, receivership or the making of a company voluntary arrangement will give rise to a right of irritancy. In cases of individual insolvency, the specified events are generally when the tenant becomes insolvent, apparent insolvency or the signing of a trust deed conveying the estate to a trustee for the benefit of the tenant's creditors.

3.45 We consider that all of these insolvency events should trigger the offer of the moratorium. One approach would be to provide a list of insolvency events, and associated insolvency practitioners, in the draft Bill. However, this could result in omissions and would not reflect any future developments in insolvency law. Therefore we have chosen to define an insolvency event affecting the tenant more broadly as an event which results in the appointment of an insolvency practitioner. In turn, we adopt the definition of insolvency practitioner from section 388 of the Insolvency Act 1986. This will cover all the insolvency events referred to above with the exception of apparent insolvency.³⁵

3.46 Special provision is required in the case of apparent insolvency since no insolvency practitioner is appointed under this procedure. In these circumstances, we propose that the tenant should be offered the moratorium in order to allow him to attempt to assign the lease. The proposed provisions as to service of the moratorium notice and any further notices should therefore apply to the tenant but, where separate provision is made for service on the tenant, not so as to require double notice on the tenant.

3.47 A lease may specify that the appointment of a judicial factor gives rise to an option to terminate. Although a survey of irritancy clauses indicates that this is an uncommon occurrence, we recognise that this event does not fall within our definition of an insolvency event affecting the tenant. However, we do not consider that the appointment of a judicial factor should be considered as such. A judicial factor is an officer appointed by the court to collect, hold and administer an estate which is without "capable administration" or which is the subject of litigation³⁶ and therefore may be appointed in circumstances not related to insolvency. In general terms, judicial factors have a duty to protect and administer the factory property rather than realise it for the benefit of creditors. Instead, the appointment of a judicial factor would be covered by the residual category discussed below as an event triggering irritancy not being an insolvency event affecting the tenant under an assignable lease.³⁷

³³ Or if there is no insolvency practitioner, the tenant.

³⁴ The examples included standard commercial leases from the following solicitor firms: Shepherd & Wedderburn, Burness, Maclay Murray & Spens, Semple Fraser, Sinclair McCormick & Giusti Martin and McGrigor Donald.

³⁵ As defined in s 7 of the Bankruptcy (Scotland) Act 1985.

³⁶ See J C Irons, *The Law and Practice in Scotland relative to Judicial Factors* (1908), p 1.

³⁷ See paras 3.59ff below.

3.48 Therefore we recommend that:-

13. (a) **Where the rights of the tenant under a lease may be assigned, an option to terminate a lease on account of an insolvency event affecting the tenant should not be exercisable unless the tenant's insolvency practitioner has been offered a suspension of the exercise of the option to terminate for a specified period by way of a moratorium notice.**

(Draft Bill, section 5(1))

- (b) **For this purpose, an insolvency event affecting the tenant means the tenant's insolvency or apparent insolvency or any event which results in the appointment of an insolvency practitioner.**

(Draft Bill, section 19(1))

- (c) **For this purpose, an insolvency practitioner means a person who, in relation to the tenant, acts or is entitled to act as an insolvency practitioner under section 388 of the Insolvency Act 1986.**

(Draft Bill, section 19(1))

- (d) **Where there is an insolvency event affecting the tenant but there is no insolvency practitioner, the tenant should be offered a suspension of the exercise of the option to terminate for a specified period by way of a moratorium notice.**

(Draft Bill, section 6(3))

3.49 It will be noticed that this scheme only operates where the lease is capable of being assigned. Of course, all leases are capable of being assigned with the consent of the landlord. This concept therefore requires further definition. For this purpose, we propose that a lease should be treated as capable of being assigned only where either the landlord's consent is not required at all or the landlord does not have an absolute veto in respect of an assignation. Where, for example, the landlord had an absolute veto, it would be pointless to prevent him from immediately irritating the lease on an occurrence of an insolvency event when during the moratorium period he has the power to prevent any assignation of the lease from taking place. Similarly, the scheme would not be appropriate if the lease could not be assigned as a consequence of *delectus personae*.³⁸ Insolvency events affecting the tenant of a lease which is not assignable fall into the residual category of rights to terminate considered below.³⁹ However, in the typical case where the landlord's consent to an assignation must not be unreasonably withheld, the lease would be treated as assignable because the landlord has no absolute discretion over the withholding of consent.

³⁸ Eg leases of agricultural holdings were traditionally not assignable but see s 10A of the Agricultural Holdings (Scotland) Act 1991, to be inserted by s 66 of the Agricultural Holdings (Scotland) Act 2003. Also the new LDTs will be assignable: see 2003 Act, s 7.

³⁹ See paras 3.59ff below.

3.50 We therefore recommend that:-

14. **For this purpose, a lease is capable of being assigned only if it can be assigned without the consent of the landlord or the landlord does not have an absolute veto in respect of any necessary consent to the assignment.**

(Draft Bill, section 19(1))

3.51 When the landlord's option to terminate the lease is triggered by an insolvency event affecting the tenant under an assignable lease, we have recommended that the landlord cannot serve a notice of termination without first giving the tenant's insolvency practitioner an opportunity to try to assign the lease. This would be done by the landlord serving a moratorium notice on the tenant and the insolvency practitioner, warning them of the landlord's intention to terminate the lease and offering the insolvency practitioner a period of time, the moratorium, in which he can attempt to assign the tenant's rights under the lease free from the threat of irritancy on account of the insolvency event. The purpose of the moratorium is to provide an opportunity for the lease to be assigned. Therefore if the insolvency practitioner does not intend to assign the lease because it is of no value, or for any other reason, the option to irritate should be available immediately. The insolvency practitioner would therefore have 28 days after service of the notice to decide whether or not to accept the offer. If the offer was not accepted after 28 days, the landlord would become entitled to serve a notice of termination.

3.52 Where the insolvency practitioner accepts the offer of the moratorium within the 28 day period, the moratorium would last for 6 months after the expiry of that period, or for any longer period allowed by the lease. Thus if the insolvency practitioner accepted the offer on the date the moratorium notice was served, he would have a moratorium of 28 days and 6 months within which the right to terminate for the insolvency event could not be exercised. The moratorium should be capable of being extended at any time prior to service of a notice of termination by agreement between the landlord and the insolvency practitioner.

3.53 It has been suggested to us that our policy aim could be frustrated by landlords who deliberately delay responding to a request for consent to an assignation during the moratorium. Accordingly, we propose that at any time prior to the expiry of the moratorium, the insolvency practitioner should be able to apply to the court for an extension of that period on the ground that the landlord was in breach of an obligation relating to consent to an assignation of the tenant's rights or has otherwise caused unreasonable delay in relation to such consent. In either case, if the application was successful, a reference to the moratorium period would be a reference to the moratorium as so extended.

3.54 Where the moratorium expires without the tenant's rights having been assigned or where the offer of the moratorium is not accepted, then and only then, could the landlord serve a notice of termination based on the insolvency event which would terminate the lease on a date specified in the notice. The specified date could be no earlier than the date of service of the termination notice.⁴⁰ The notice of termination should be served on both the tenant and the insolvency practitioner.

⁴⁰ For agricultural leases, see para 3.66 below.

3.55 Accordingly, we recommend that:-

15. (a) **The moratorium notice should be served on the tenant and the tenant's insolvency practitioner.**
- (b) **The moratorium notice should give a warning of the landlord's intention to terminate the lease and offer the insolvency practitioner a period of time in which to attempt to assign the lease before termination can occur.**
- (c) **The offer of a moratorium should be open for acceptance by the tenant's insolvency practitioner for a period of 28 days.**
- (d) **If (i) the offer is not accepted within that period or (ii) the offer is so accepted but the moratorium expires without the tenant's rights under the lease having been assigned, the landlord may proceed to serve a notice of termination founded upon the insolvency event.**

(Draft Bill, section 5(1))

- (e) **The moratorium should not be less than the longer of:**
 - (i) **a period of 6 months after the 28 days allowed for acceptance of the offer of the moratorium; or**
 - (ii) **any longer period allowed in the lease.**

(Draft Bill, section 5(2))

- (f) **The moratorium period should be capable of being extended either:**
 - (i) **at any time before the date of service of a notice of termination, by agreement between the landlord and the insolvency practitioner; or**
 - (ii) **at any time before the expiry of the period allowed in the moratorium notice, by the court where it is satisfied that the landlord has either (a) breached an obligation relating to consent to an assignation of the lease; or (b) has otherwise caused unreasonable delay in relation to such consent.**

(Draft Bill, section 5(3))

3.56 During the moratorium the insolvency practitioner is the party in control of the lease. Thus any notices which the landlord is obliged to serve on the tenant should also be served on the insolvency practitioner in order that he may exercise the tenant's rights in relation to such a notice. In exchange for recognition of the insolvency practitioner and his entitlement to deal with the lease, landlords may expect him to adopt some responsibility for the tenant's obligations. However, in practice insolvency practitioners are not prepared to undertake personal liability for the tenant's obligations or to adopt the lease. As a result, provisions commonly inserted in commercial leases whereby the landlord offers the

insolvency practitioner an opportunity to assign the lease in exchange for an undertaking to perform the tenant's obligations (or at least to pay the rent over a specified period) are not used in practice. It is therefore important to make clear that acceptance of the offer of a moratorium should not impose liability on the insolvency practitioner for any of the tenant's obligations nor imply that he has adopted the lease.

3.57 However, the moratorium only prevents the exercise of irritancy in respect of the insolvency event. There are no policy reasons why the insolvent tenant should be treated differently in the enforcement of his lease obligations. The landlord's ability to use the remedy in respect of any breach or other event is unaffected although subject to the respective protections which we recommend in this report. This means that if during the moratorium the tenant breaches a term of the lease which triggers an option to terminate or an option to terminate is triggered by the happening of another event (not related to the insolvency) the landlord may take steps to exercise that option in spite of the moratorium. However, depending on the type of insolvency event which has occurred, the consent of the court or the insolvency practitioner to the exercise of the right of irritancy may be required.⁴¹ We propose that such consent should only be required before the service of the termination notice and not at the stage of service of any prior notices. To give an example:-

During a moratorium granted on account of T's administration, T fails to pay the rent. This triggers L's right to irritate the lease on the ground of T's breach of a monetary obligation. In spite of the moratorium, L is entitled to serve a 28 day warning notice on T (and if applicable the insolvency practitioner). If T fails to pay within that period, L becomes entitled to serve a termination notice on T which will bring the lease to an end on the specified date. Subject to obtaining any necessary consents for the purposes of the Insolvency Act 1986 and the Enterprise Act 2002, the lease will then be terminated even although the moratorium period has not expired.

3.58 Therefore we recommend that:-

16. Where a moratorium has been accepted:

- (a) the landlord's right to terminate the lease on account of any breach of the tenant's obligations or on the occurrence of any event other than the relevant insolvency event is unaffected;**
- (b) any warning notice served during that period, or any subsequent notice of termination, should be served on both the tenant and the insolvency practitioner;**
- (c) the insolvency practitioner should be entitled to exercise the tenant's rights in relation to any such notice;**
- (d) the insolvency practitioner should not thereby incur any liability for any of the tenant's obligations nor be taken to have adopted the lease.**

(Draft Bill, section 6)

⁴¹ See paras 1.27-1.29 above.

Non-remediable breach or events other than insolvency events affecting the tenant under an assignable lease

3.59 A landlord's option to terminate may be triggered by a non-remediable breach or an event other than an insolvency event affecting the tenant under an assignable lease. The definition of a "non-remediable" breach which we propose to use for this purpose is very restricted.⁴² We believe that occurrence of such breaches or events⁴³ and therefore the ability to terminate the lease on such grounds are rare. Indeed, it is difficult to envisage a breach that is truly non-remediable. It was suggested to us that such a breach could arise, for example, if the landlord was entitled to irritate because the tenant had sub-let without authorisation or had used the premises for a prohibited purpose which would have a significantly detrimental effect on the landlord's interests and which could not be reversed.⁴⁴ However, on our construction we believe that both these cases are in fact examples of remediable breach. The unauthorised sub-lease is void,⁴⁵ and the prohibited use may be ceased, although the loss caused by that use may not be recoverable other than by way of damages. While the landlord can seek redress through alternative remedies, for example, reduction of the sub-lease or damages, on consultation it was evident that there was significant support for retaining the right to irritate in such circumstances. A perhaps strained example of a non-remediable breach is where the tenant has obtained planning permission for the development of the premises in breach of a prohibition against doing so without the landlord's consent. Once obtained the permission cannot be reduced and so the breach is not remediable. However, we consider this would be unlikely to occur in practice as the landlord would require to be notified of any application for planning permission in his capacity as owner.

3.60 It will be obvious that a warning notice or moratorium notice is inappropriate for this kind of irritancy. Since the tenant had committed a breach or otherwise triggered the irritancy which could not be purged, we did consider whether irritancy should be allowed to operate without restriction in such cases. However, we have concluded that fairness demands that before the lease is terminated the tenant should receive notice that the landlord intends to irritate the lease in order that there is an opportunity for any valid challenge to be made. Moreover, we take the view that in these limited circumstances where there is no other protection available to the tenant, (the obsolete common law equitable power of relief having been abolished under our proposals) the tenant requires recourse to some protection in cases of extreme hardship.

3.61 Accordingly, we consider that an option to terminate a lease on the ground of a non-remediable breach, or an event not being an insolvency event affecting the tenant under an assignable lease, should not be effective unless the landlord has served a notice of termination on the tenant. The notice of termination should specify a date when the lease is to be terminated. Following our approach in relation to the notification period for remediable breach, we propose that the specified date must not be less than 28 days after the

⁴² See para 3.26 above.

⁴³ Although as noted above, insolvency events affecting a tenant under a lease that is not assignable fall outwith the moratorium scheme, the majority of leases are assignable.

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

⁴⁵ *Trade Development Bank v Warriner and Mason (Scotland) Ltd* 1980 SC 74, 1980 SLT 223.

date of service of the termination notice on the tenant.⁴⁶ If the notice of termination is valid, the lease will be terminated on the specified date.

3.62 Because by definition the tenant cannot purge the irritancy by remedying any breach,⁴⁷ we feel that the tenant should be entitled to seek relief if the termination of the lease would be a manifestly excessive response to the breach (or other triggering event). In our Report on *Penalty Clauses*,⁴⁸ we recommended that the "manifestly excessive" test be used as the criterion for judicial control of contractual penalties. This sets the threshold for judicial intervention at a fairly high level. The excessive nature of the exercise of the option to terminate should be immediately obvious and not a matter of nice calculation. An application to the court for such relief should be made within 28 days from the date of service of the notice of termination.⁴⁹ As long as the application for relief is before the court, the notice of termination will be suspended. In determining the application, the court must attempt to balance the harm sustained by the landlord as a result of the breach against the harm which will be sustained by the tenant should the lease be terminated. It will be important to consider whether the landlord could receive adequate compensation by suing the tenant for damages rather than terminating the lease. Another important factor would be whether the tenant will forfeit the value of improvements and other developments he has undertaken on the property and if this loss is disproportionate to the loss sustained by the landlord as a consequence of the breach. For the reasons given above,⁵⁰ the tenant cannot recover the value of such gains from the landlord under the principles of unjustified enrichment. Rather, if a court considers that, on balance, the termination of the lease would be a manifestly excessive response, we propose that it should be entitled either to stop the irritancy from proceeding by declaring the notice to be ineffective or to delay its effect by postponing the termination date. This may be appropriate to allow the tenant sufficient time to remove from the premises or perhaps, where the premises are his home, to secure alternative accommodation. Where an application is refused by the court, the notice of termination would take effect on the specified date or on the date of refusal if later.

3.63 Therefore we recommend that:-

17. (a) **Where an option to terminate arises in respect of (i) a breach that is not remediable or (ii) any other event, not being an insolvency event affecting the tenant under an assignable lease, the lease should not be terminated unless the landlord serves a notice of termination on the tenant.**
- (b) **When the tenant has been served with such a notice of termination, he should be able to apply to the court to declare the notice ineffective or to postpone its effect on the ground that the termination of the lease would be a manifestly excessive response to the breach or other triggering event.**
- (c) **The application for relief should be made within 28 days of the service of the notice of termination.**

⁴⁶ For agricultural leases, see para 3.66 below.

⁴⁷ Nor is he likely to be able to reverse "any other event" that triggers the irritancy.

⁴⁸ Scot Law Com No 171.

⁴⁹ Ie before the notice of termination has taken effect.

⁵⁰ Paras 2.21-2.22 above.

(d) While the application for relief is before the court, the effect of the notice of termination should be suspended.

(Draft Bill, sections 8 and 9)

Notice of termination - specified dates

3.64 It will now be clear that where an option to terminate has been triggered by a remediable breach, the landlord is unable to serve a notice of termination until he has served a warning notice and the time stipulated in the notice has passed without the breach being remedied. Similarly, where an option to terminate has been triggered by an insolvency event affecting the tenant under an assignable lease, the landlord cannot serve a notice of termination unless he has served a moratorium notice and either the insolvency practitioner has not accepted the moratorium or the period of the moratorium has passed and the insolvency practitioner has been unable to assign the lease. Only in respect of irritancies triggered by non-remediable breaches or events other than an insolvency event affecting the tenant under an assignable lease is the landlord entitled to proceed directly to terminate the lease by serving a notice of termination on the tenant.

3.65 Throughout this report, we have referred to the date that the lease is brought to an end as the specified date. It is convenient at this stage to summarise the proposed rules. A notice of termination must specify a date when the lease is to be terminated and unless the notice can be challenged, the lease will come to an end on that date.⁵¹ When the notice of termination has been served after the expiry of a warning notice or a moratorium notice, the specified date must not be earlier than the date of service of the notice of termination. When the notice of termination does not follow on a warning notice or moratorium notice, the specified date must be not less than 28 days after the date of service of the notice of termination.

3.66 The current policy of allowing tenants of short limited duration tenancies and limited duration tenancies a period of 2 months' notice of removal⁵² requires to be integrated with our proposals. We understand that this period is allowed so as to afford the tenant time to make arrangements for removal from the subjects, including any stock or equipment. We see no reason why, if this is thought necessary, this should not be extended to all leases of agricultural subjects. Therefore, where the lease to be terminated is an agricultural lease we propose that the specified date in the notice of termination should not be less than 2 months after the date of service of the notice.⁵³

3.67 We considered whether there should be a time limit on when a landlord could serve a notice of termination following a warning notice or moratorium notice. If, for example, a warning notice has expired and the breach has not been remedied is it fair on a tenant that the landlord can serve a notice of termination on him at any time for an indefinite period?⁵⁴ This is all the more striking as, throughout that time, the tenant cannot purge the breach

⁵¹ Where the irritancy is triggered by a non-remediable breach or an event other than an insolvency event affecting the tenant under an assignable lease, the court will have the power to prevent the operation of the notice or delay its effect if the termination of the lease would be a manifestly excessive response to the breach or the event: see paras 3.59ff above.

⁵² Agricultural Holdings (Scotland) Act 2003, s 18(6) and (7).

⁵³ S 18(6) and (7) are therefore rendered obsolete and should be repealed; see draft Bill s 21 and sch 2.

⁵⁴ The right to serve the notice would be extinguished by twenty years prescription as a right relating to heritable property: Prescription and Limitation (Scotland) Act 1973, s 8.

since the period for doing so in the warning notice has passed. On the other hand, this is the position in relation to conventional irritancies under the current law and consultees assured us that this does not lead to any major difficulties in practice. We are also aware that a landlord who does not serve a notice of termination timeously may well be met by a challenge to the notice on the grounds of mora or personal bar should he attempt to do so. In these circumstances we have decided to make no recommendation on this issue.

3.68 Accordingly we recommend that:-

18. (a) **A notice of termination should specify a date upon which the lease is to be terminated.**
- (b) **Where the lease is not an agricultural lease:**
 - (i) **when the notice of termination follows a warning notice or a moratorium notice, the date of termination may be no earlier than the date of service of the notice of termination; or**
 - (ii) **in any other case, the date of termination may be no earlier than 28 days after the date of service of the notice of termination.**
- (c) **Where the lease is an agricultural lease, the date of termination may be no earlier than 2 months after the service of the notice of termination.**
- (d) **Unless the notice of termination is successfully challenged, the lease will terminate on the specified date.**

(Draft Bill, sections 7 and 8)

Notices

3.69 **Form of notice.** It will be apparent that notices have a fundamental role in our proposals. It is essential in the interests of fairness that when he receives a notice, a tenant should know what is required by the landlord and the consequences of a failure to comply. The language of the notices should be clear and unambiguous. In addition, we think that it would be helpful to a tenant if the notice was accompanied by notes which explained the legal position as simply and accurately as possible. We therefore propose that the notices should be in statutory form and should be accompanied by explanatory notes. The forms and notes are to be found in schedule 1 to the draft Bill and may be modified from time to time by the Scottish Ministers⁵⁵ to reflect any future changes in the law or best practice. If a notice is not in statutory form or is otherwise inaccurate, we consider that it should be open to challenge by the tenant on the ground that it was not in accordance with the mandatory formalities stipulated in the proposed legislation. However, we take the view that any trivial inaccuracy or formal irregularity, for example, a spelling mistake, should be disregarded if it could not result in prejudice to the tenant or other recipient.

⁵⁵ By order made by statutory instrument subject to negative resolution procedure: see draft Bill, s 10.

3.70 **Method of service.** It is clearly important that the tenant should receive the notice and appreciate that it is an important document. On the other hand, we do not think that a landlord should have to go to inordinate lengths to ensure that a notice has in fact been received by the tenant.⁵⁶ In so far as the method of service is concerned, in order to emphasise the importance of the document and to facilitate ready proof of its service, we have taken the view that it must be served by recorded delivery or by a sheriff officer. Where the lease contains additional requirements in respect of the method of service, for example by e-mail to particular persons, these should also be complied with.

3.71 **Place of service.** Most leases will make specific provision for the service of notices. We do not propose to interfere with the parties' freedom in this regard. Therefore we propose that where the parties have agreed the place for service of notices the terms of that agreement should be observed. If, however, the lease does not stipulate the place for service, we consider that the notice should be treated as served if the landlord posts it by recorded delivery to any of the following:-

the recipient's last business address known to the landlord;

the recipient's last residential address known to the landlord; or

in the case of the tenant, the subjects of the lease if they have a postal address.

In this way a landlord will not be prevented from serving the required notices and irritating a lease where the whereabouts of the tenant are unknown.

3.72 **Service on heritable creditors.** We also considered whether copies of notices should be served on third parties such as the tenant's heritable creditors or sub-tenants. After consultation, we have taken the view that any requirement of service on third parties must not be too onerous for the landlord. In these circumstances, we consider that, apart from service on insolvency practitioners in relation to a moratorium period,⁵⁷ the only third party to whom copies of notices should also be served are heritable creditors who have a right in security over the lease. While today the most common form of heritable security over a lease is the standard security, we have referred to rights in security in general terms as older forms of security may still be applicable (such as a bond and assignation in security) and new forms of heritable securities may be devised in the future. We propose that such rights should qualify for this purpose if and only if the security has been recorded in the Register of Sasines or the rights of the creditor have been registered in the Land Register by a date which is at least 7 days prior to the date of service of the notice. When a copy of a warning notice or a moratorium notice has been served on a heritable creditor, a copy of any notice of termination following on such a notice should also be served on the heritable creditor. Failure to serve a copy of a notice on a qualifying heritable creditor should be a ground for challenging the notice served on the tenant. With the exception of the availability of recorded delivery at the subjects of the lease, the provisions in respect of the method and place of service of a notice on the tenant should also apply in respect of service of a copy of the notice on heritable creditors.⁵⁸

⁵⁶ Even more difficult would be to ensure that the notice was received by the person within a business organisation who had the power to act upon the notice.

⁵⁷ See paras 3.43ff above.

⁵⁸ The same provisions should also apply to the service of notices on insolvency practitioners.

3.73 **Date of service.** The date of service of notices is also important as it constitutes the beginning of the period allowed for action to be taken by the tenant or other recipient. We have taken the view that for these purposes the date of service of a notice should be the date when it is served by a sheriff officer, or the day after the date of posting when recorded delivery is used. Where the landlord is required to serve a copy of the notice he should attempt to do so as nearly as possible at the same time as he serves the actual notice.

3.74 **Challenge of notice.** Finally, we think that a tenant or other recipient should be entitled to challenge any notice by an application to the court. Any time period allowed for action to be taken by a tenant or other recipient in response to a warning notice should not run, nor should a moratorium notice or notice of termination take effect, for so long as a challenge to the notice is before the court. A notice could be challenged on the ground that it is not in accordance with the provisions of the proposed legislation, for example, that it is not in the proper form or has not been served within the correct time period. Alternatively, a challenge could be made because as a matter of substantive law it should not have been served, for example, because the tenant was not in breach of an obligation which could trigger an option to terminate the lease. However, the fact that a notice has not been challenged by an application to the court during any period specified in the notice for action to be taken should not prevent the notice being challenged at a later stage. Thus, for example, if a tenant does not challenge a warning notice or subsequent notice of termination before the expiry of the specified date, that should not prevent the tenant challenging the notice(s) in proceedings for his removal. The effect of a successful challenge will be that the notice is null so that a declarator will be the primary remedy; as the notice is null there is no need to seek its reduction.⁵⁹

3.75 Therefore we recommend that:-

19. **(a) The forms of warning notices, moratorium notices and notices of termination and the explanatory notes that accompany them, should be substantially in the form provided by statute.**

(Draft Bill, sections 10 and 13(1) and schedule 1)

- (b) A copy of a warning notice or a moratorium notice or a notice of termination in respect of which no warning notice or moratorium notice was required should be served on qualifying heritable creditors.**

(Draft Bill, section 11(1))

⁵⁹ Where there are reasons why reduction is in fact sought as a remedy the action will need to be raised in the Court of Session rather than the sheriff court.

(c) In this context, a qualifying heritable creditor means one who has a right in security over the lease which has been recorded in the General Register of Sasines or registered in the Land Register by a date occurring at least 7 days prior to the date of service of the notice in question.

(Draft Bill, section 11(2))

(d) Where a warning notice or a moratorium notice was required to be served on a heritable creditor, a copy of any notice of termination following on such a notice should also be served on that creditor.

(Draft Bill, section 11(3))

(e) Service of notices or copies of notices should be effected by recorded delivery or by sheriff officer and in accordance with any additional requirements stipulated in the lease.

(Draft Bill, section 12(1) and (2)(a))

(f) A notice or copy of a notice should be served at the place stipulated in the lease for the purpose of such service.

(Draft Bill, section 12(2)(b))

(g) Where no place is stipulated in the lease for the purpose of service, service of a notice or a copy of a notice may be effected by sending the notice to any of the following:-

the recipient's last business address known to the landlord;

the recipient's last residential address known to the landlord; or

in the case of a notice addressed to the tenant only, at the subjects of the lease if they have a postal address.

(Draft Bill, section 12(3))

(h) The date of service of a notice should be the date when it is served if served by a sheriff officer or the day after the date it is posted if service is effected by recorded delivery.

(Draft Bill, section 12(4))

(i) The tenant or other recipient of a notice should be able to challenge the notice by an application to the court on the ground that the notice is not in accordance with the provisions of the proposed legislation or is otherwise ineffective.

(Draft Bill, section 13(1))

(j) The fact that a tenant or recipient does not challenge the notice by an application to the court during any period specified in the notice for action to be taken should not prevent it being challenged at a later stage.

(Draft Bill, section 13(3))

Contracting out

3.76 Because of the potency of the landlord's option to terminate a lease, we consider that parties should not be entitled to contract out of the proposed statutory controls which have been designed to protect the tenant.⁶⁰ However, it may be in the interests of a tenant who has received a moratorium notice or a notice of termination following thereon, that the lease be terminated at an earlier date than would otherwise be permitted under our proposals. For example, an agricultural tenant may wish to proceed directly to quitting the holding in order to receive the compensation he is entitled to at waygo. Similarly, an insolvency practitioner may be able to negotiate the payment of a premium for immediate removal if the landlord has agreed terms with a new tenant conditional on early entry. In these circumstances, we consider that the tenant should be free to enter into an agreement with the landlord for early termination of the lease. We also propose that parties should be able to "contract out" of the statutory option to terminate for non-payment of rent.⁶¹

3.77 Therefore we recommend that:-

20. (a) Except as further provided, any provision of a lease whereby parties contract out or purport to contract out of the proposed legislation should have no effect.

(b) This does not prevent a tenant who has received a moratorium notice or a notice that the lease is to be terminated for an insolvency event from entering into an agreement with the landlord that the lease is to terminate earlier than would otherwise be allowed under the proposed legislation.

(Draft Bill, section 17)

The possible effect of our proposals on the commercial property market

3.78 Our research did not disclose that the potential economic consequences for the tenant of the landlord's option to terminate a lease had any detrimental effect on commercial development in Scotland. The results of our survey of companies and bodies active in the commercial property market originally published in our discussion paper is reproduced as Appendix D. A list of those who took part in the survey can be found in Appendix E.

3.79 Conversely, responses to the discussion paper indicated that the existence of the right to irritate a lease was in fact perceived to be an incentive to invest in Scottish property. Accordingly our proposals are an attempt to provide a regime which ensures fairness to

⁶⁰ This is the position under the 1985 Act, see s 6(1).

⁶¹ Para 3.15 above.

tenants while retaining irritancy as a valuable compulsitor for performance and, ultimately, a clean, effective way to terminate the lease of an unsatisfactory tenant.

Part 4 Legislative Competence

Introduction

4.1 In this Part we consider whether the terms of the draft Bill fall within the legislative competence of the Scottish Parliament.

4.2 An Act of the Scottish Parliament is not law so far as any provision of the Act is outside the legislative competence of the Parliament.¹ Section 29(2) of the Scotland Act 1998 ("the 1998 Act") provides that a provision is outside that competence where:-

- (a) it would form part of the law of a country or territory other than Scotland, or confer or remove functions exercisable otherwise than in or as regards Scotland;
- (b) it relates to reserved matters (which are set out in schedule 5 to the 1998 Act);
- (c) it is in breach of the restrictions in schedule 4 to the 1998 Act;
- (d) it is incompatible with any of the Convention rights or with Community law; or
- (e) it would remove the Lord Advocate from his position as head of the systems of criminal prosecution and investigation of deaths in Scotland.²

4.3 For our purposes, the relevant issues are: (1) do our proposals for reform of the law of irritancy relate to reserved or devolved matters, (2) do they breach the restrictions in schedule 4 to the 1998 Act and (3) are they compatible with the European Convention on Human Rights.

Schedule 5 and reserved matters

4.4 The provisions of the draft Bill regulate the exercise of a remedy available in Scots private law. Therefore *prima facie* this would seem to relate to devolved matters and thus fall within the legislative competence of the Scottish Parliament.

4.5 However, our recommendations include the statutory control of the exercise of rights of irritancy which arise on insolvency events affecting the tenant.³ Certain aspects of insolvency law in relation to business associations are reserved matters under section C2(a) of schedule 5. This raises the question of whether where irritancy is triggered by certain events relating to business associations,⁴ our proposals for the moratorium fall within reserved matters as a legal effect of winding up under section C2(a) or as arrangements with creditors under section C2(d).⁵ In addition, it could be argued that our proposals could be

¹ Scotland Act 1998, s 29(1).

² *Ibid*, s 29(2).

³ See paras 3.43ff above and draft Bill, s 5.

⁴ *Ie* liquidation, administration, and company voluntary arrangements.

⁵ The law relating to receivership is specified as an exception under s C2 and as such is a devolved matter. It also seems clear that any matter relating to personal insolvency is a devolved matter since the reservation is limited to business associations.

described as a procedure giving protection from creditors and as such touch on matters reserved under section C2(e) of schedule 5.

4.6 **Purpose of the reform.** In order to determine whether a provision relates to a reserved matter, reference must be made to the purpose of the provision having regard to its effect in all the circumstances.⁶ The primary purpose test operates so as to provide that matters do not fall outwith competence because the provision incidentally affects reserved matters.

4.7 The primary purpose of our proposals for reform is to provide protection for tenants against the exercise of a landlord's remedy under the lease. Our recommendations cover the whole of the Scots private law of legal and conventional irritancy and are not limited to irritancy arising on the occurrence of insolvency events. This purpose is therefore far removed from the substance of the reservation in section C2(a) which deals with modes of, initiation of and effect of winding up and in section C2(d) concerning arrangements with creditors. Moreover, any protection against creditors afforded by our proposals is limited in its extent. The protection is only afforded against the tenant's landlord who need not in fact be a creditor. The circumstances which trigger the protection are not that the tenant is indebted. The trigger is a right which arises under the lease. We therefore take the view that having regard to the purpose of our recommendations, our proposals do not fall within the scope of section C2 of schedule 5.

4.8 **The test in section 29(4).** When dealing with Acts which make modifications of "Scots private law" regard must also be had to section 29(4) of the 1998 Act. Under this section a provision which would not otherwise relate to a reserved matter but which makes modifications to Scots private law as it applies to reserved matters will fall outwith the competence of the Scottish Parliament unless the purpose of the provision is to make the law apply consistently to reserved matters and otherwise.

4.9 The subject matter of the draft Bill falls within the definition of Scots private law given in section 126(4).⁷ Irritancy could be categorised as part of both the law of obligations and the law of property. The draft Bill makes modifications of Scots private law as it applies to reserved matters consistently with its application to non-reserved matters. For example, the moratorium will operate in the same manner regardless of whether the event triggering the irritancy is the receivership of the tenant (clearly a devolved matter) or the tenant's liquidation (which as discussed above may arguably be a reserved matter).

4.10 **Conclusion.** Therefore, although the position is not clear-cut, nevertheless we believe that there are several grounds supporting the view that on a purposive interpretation of our recommendations, implementing legislation would not relate to reserved matters.

⁶ Scotland Act 1998, s 29(3).

⁷ "References in this Act to Scots private law are to the following areas of the civil law of Scotland - (a) the general principles of private law (including private international law), (b) the law of persons (including natural persons, legal persons and unincorporated bodies), (c) the law of obligations (including obligations arising from contract, unilateral promise, delict, unjustified enrichment and *negotiorum gestio*), (d) the law of property (including heritable and moveable property, trusts and succession), and (e) the law of actions (including jurisdiction, remedies, evidence, procedure, diligence, recognition and enforcement of court orders, limitation of actions and arbitration), and include references to judicial review of administrative action." Ibid, s 126(4).

Schedule 4

4.11 By virtue of section 29(2)(c) of the 1998 Act, the test of legislative competence also includes compliance with the provisions of schedule 4. Paragraph 2 of that schedule provides that an Act of the Scottish Parliament cannot modify the law on reserved matters unless the exceptions in paragraphs 2(3) or 3(1) are engaged.

4.12 In our view the draft Bill does not relate to reserved matters. However, if this argument were to be rejected, it is submitted that the draft Bill would be brought within legislative competence under the exceptions in paragraphs 2(3) or 3(1).

4.13 Under paragraph 2(3), the prohibition on the modification of a rule of Scots private law relating to a reserved matter is only effective to the extent that the rule in question is special to that matter. Irritancy is a rule of Scots private law for this purpose. It is submitted that the modification proposed in relation to the moratorium is not special to the reserved matter as it applies consistently to all changes in status which may trigger the moratorium whether the triggers are devolved or reserved.

4.14 In addition it is argued that the proposed modifications to reserved matters satisfy the requirements of paragraph 3(1) necessary to exclude them from the scope of paragraph 2(1). They are incidental to or consequential on the control of irritancy. They also do not have a greater effect on reserved matters than necessary to give effect to this purpose.

4.15 We therefore do not consider that the terms of the draft Bill breach the restrictions in schedule 4.

European Convention on Human Rights

4.16 **Introduction.** For our purposes, the relevant provisions are Article 1 of the First Protocol to the European Convention on Human Rights ("ECHR") (the right to peaceful enjoyment of property) and Article 14 of the Convention (discrimination).

4.17 **Article 1.** Article 1 of the First Protocol to the ECHR 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 conditions 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."

4.18 When a landlord exercises his right to irritate, this has the effect of depriving the tenant of his rights under the lease. Those rights are recognised as "possessions" within the scope of Article 1.⁸

⁸ See, for example, *Mellacher v Austria* (1990) 12 EHRR 391.

4.19 We explored the compatibility of irritancy with Article 1 in the discussion paper.⁹ We took the view that the State is not under an obligation to protect a tenant from the effects of irritancy.¹⁰ The landlord's right to irritate is derived from the lease and is therefore a matter of private negotiation between the parties. Therefore, as our reforms will enhance the protection available to a tenant from the effects of a conventional irritancy clause to which he has agreed, we consider it unlikely that our proposals would fall foul of Article 1.

4.20 **Article 14.** Article 14 provides that:

"The enjoyment of the rights and freedoms set forth in this Convention shall be secured without discrimination on any ground such as sex, race, colour, language, religion, political or other opinion, national or social origin, association with a national minority, property, birth or other status."¹¹

4.21 Article 14 does not confer a substantive, independent right to freedom from discrimination and can only be applied in relation to the rights and freedoms conferred by other provisions of the ECHR.¹² However, there does not need to be a violation of one of the substantive articles before Article 14 is engaged. Even if the main article was not breached in itself, the facts may show a breach of that article when it is read in conjunction with Article 14 because the measure in question is of a discriminatory nature.

4.22 Clearly there requires to be different treatment before Article 14 is engaged but this does not in itself amount to discrimination. There will only be a breach of Article 14 if the applicant can prove that he is being treated differently from those in a relatively similar position¹³ and if there is no "objective and reasonable justification" for the difference in treatment, that is to say where the different treatment does not pursue a "legitimate aim" and there is no "reasonable relationship of proportionality between the means employed and the aim sought to be realised."¹⁴

4.23 The law of irritancy does not fall within the usual ambit of cases which are found to be discriminatory under Article 14 of the ECHR. The majority of cases breaching Article 14 relate to the more obvious cases of discrimination based on gender,¹⁵ sexual orientation,¹⁶ religion,¹⁷ nationality¹⁸ and the legitimacy of children.¹⁹ However it has been suggested to us that in order to prevent a possible breach of Article 1 read in conjunction with Article 14, any

⁹ At paras 2.14 - 2.19.

¹⁰ See *Di Palma v United Kingdom* (1988) 10 EHRR 149 and discussion paper, para 2.15.

¹¹ The list of prohibited grounds of discrimination set out in Article 14 is not exhaustive. See *Rasmussen v Denmark* (1985) 7 EHRR 371 at para 34.

¹² See *Abdulaziz, Cabales and Balkandali v United Kingdom* (1985) 7 EHRR 471 at para 71 - "Although the application of Article 14 does not necessarily presuppose a breach of those provisions - and to this extent it is autonomous - there can be no room for its application unless the facts at issue fall within the ambit of one or more of the latter." For example, in *Botta v Italy* (1998) 26 EHRR 241 there was no violation of Article 14 where there was a lack of access for disabled persons at a beach because this did not fall within the ambit of any substantive Convention right.

¹³ *Spadea and Scalabrino v Italy* (1996) 21 EHRR 482 at para 45 - "Article 14 will be breached where, without objective and reasonable justification, persons in "relatively" similar situations are treated differently. For a claim of violation of this Article to succeed, it has therefore to be established, inter alia, that the situation of the alleged victim can be considered similar to that of persons who have been better treated."

¹⁴ *Inze v Austria* (1988) 10 EHRR 394.

¹⁵ *Van Raalte v Netherlands* (1997) 24 EHRR 503, *Abdulaziz, Cabales and Balkandali v United Kingdom* (1985) 7 EHRR 471.

¹⁶ *Salgueiro da Silva Mouta v Portugal* (2001) 31 EHRR 47.

¹⁷ *Hoffmann v Austria* (1994) 17 EHRR 293, *Canea Catholic Church v Greece* (1999) 27 EHRR 521.

¹⁸ *Gaygusuz v Austria* (1997) 23 EHRR 365.

¹⁹ *Marckx v Belgium* (1979) 2 EHRR 330

reforms should apply consistently regardless of the event triggering the irritancy, ie the same scheme should apply to irritancy in respect of monetary breach, non-monetary breach, insolvency events affecting the tenant or any other event.

4.24 At present, the control of irritancy in respect of monetary breach is achieved differently to the control of other rights of irritancy. The court has no statutory discretion in relation to monetary breach unlike the position under section 5 of the 1985 Act.²⁰

4.25 However, our proposed reforms will arguably assimilate the protections against irritancy for monetary and non-monetary breach. In all cases where the breach is capable of remedy, a warning notice must be served providing the tenant with an adequate opportunity to remedy the breach. "Remediable breach" is defined in very broad terms.²¹ Under our proposals, a difference of approach is made between remediable and non-remediable breach. We do not anticipate that there will be many examples of non-remediable breach.²² The primary function of irritancy to secure performance of the tenant's obligations can no longer operate where that performance cannot be achieved. Different treatment is in our view justifiable. We have described the reasons behind our policy above.²³ But put briefly, the agreement can no longer be implemented and therefore the lease should be terminable by the landlord but not so as to allow him a windfall benefit out of proportion to the materiality of the breach or event giving rise to the right to irritate.

4.26 Although a different form of protection will apply to irritancy in respect of insolvency events, we do not consider this will breach Article 14 read in conjunction with Article 1. In the first place, it is doubtful whether the circumstances in which the right of irritancy arises are sufficiently similar to pass the comparability test. The occurrence of an insolvency event cannot usually be described as a breach of the lease. Rather, it is an independent event which the parties have agreed will trigger an option to terminate the lease.

4.27 However, even if the comparability test were satisfied, in our view differential treatment is justifiable on policy grounds. Our recommendations seek to provide an opportunity for a potentially valuable asset to be realised for the benefit of the tenant's creditors as a whole. At the same time an effective remedy is preserved to allow the landlord to exercise his contractual remedy should that realisation not be possible within a reasonable period. The policy strikes a fair balance between the interests of all parties and we would therefore submit our proposals are proportionate.²⁴

4.28 Further, national authorities enjoy a certain margin of appreciation when applying the ECHR to domestic legislation, in particular when dealing with difficult economic assessments. Such authorities are better placed to take account of local conditions. A particularly wide margin of appreciation has been given in respect of Article 1 due to the

²⁰ See paras 1.5-1.6 above.

²¹ See para 3.26 above and draft Bill, s 19(2).

²² See para 3.59 above.

²³ See Pts 2 and 3 above.

²⁴ For example, in *Spadea and Scalabrino v Italy*, (1996) 21 EHRR 482, the applicants alleged that the legislation in issue which suspended the enforcement of evictions with regards to residential housing discriminated against the owners of residential property to the detriment of owners of non-residential property. However, the Court considered that the distinction drawn between those classes of individuals was objective and reasonable given the aim of the legislation was to protect tenants during a serious housing shortage and the fact the premises were used for different purposes.

qualified nature of property rights and the controversial nature of their regulation. It therefore seems likely that the regulation of leases would be left to the domestic legislature unless there was some form of clear arbitrariness behind the legislation.²⁵

4.29 For the reasons given above, in our view our recommendations for reform would not be incompatible with the ECHR.

²⁵ For example, in *Larkos v Cyprus* (2000) 30 EHRR 597, a civil servant who rented a house from the State argued that he was discriminated against because he did not enjoy the protection which persons who rented property from private owners enjoyed. The purpose of the legislation at issue was to provide a measure of social protection for residential tenants by regulating how such tenancies were to end. The fact that he had rented his home from the government was completely irrelevant, it was still his home. It was especially arbitrary considering the State itself was protected by the legislation when it rented property from private individuals.

Part 5 List of Recommendations

1. (a) The effect of the exercise of an option to terminate a lease (ie an irritancy) should be to terminate the lease for the future except any provisions as to arbitration, compensation or quantification of damages or any other provisions intended to survive termination.

(b) The termination of the lease should not affect any rights or liabilities that have already accrued before the termination of the lease takes effect.

(Paragraph 3.5)
2. The controls over the exercise of an option to terminate a lease (ie an irritancy) should apply to any power conferred on a landlord by any enactment or rule of law including a power arising under the general law of contract to rescind a lease as a consequence of a tenant's material breach of contract.

(Paragraph 3.7)
3. (a) Nothing in the recommendations should prevent a tenant from relying on any defence, exception or ground for relief which is not specifically recommended to be abolished.

(b) Any such defence or exception or ground for relief should be capable of being used by the tenant to challenge the purported exercise of the irritancy at any stage in the proceedings.

(Paragraph 3.10)
4. Any rule of law giving the Court of Session or any other court an equitable power to grant relief to a tenant against the oppressive operation of irritancy should be abolished.

(Paragraph 3.12)
5. (a) The common law legal irritancy of non-payment of two years' rent should be abolished.

(b) The legal irritancies in respect of agricultural leases should be abolished.

(c) The legal irritancies should be replaced with an option to terminate the lease for non-payment of six months' rent.

(d) That option to terminate the lease should be subject to the same controls as a conventional irritancy for non-payment of rent.

(e) The landlord and tenant should be entitled to contract out of the statutory option to terminate.

(Paragraph 3.15)

6. The existing statutory controls on the exercise of an irritancy contained in the Law Reform (Miscellaneous Provisions) (Scotland) Act 1985 should be abolished.

(Paragraph 3.16)

7. (a) The statutory controls on the exercise of irritancy should apply to all leases of land.

(b) Nothing in those proposed controls should enable a lease to be terminated where it could not otherwise be terminated.

(Paragraph 3.18)

8. (a) An option to terminate a lease on a breach by the tenant or on the occurrence of any other event should only be exercised by the landlord serving a notice of termination on the tenant.

(b) For this purpose an option to terminate includes a right expressly conferred on the landlord under the lease, the statutory option to terminate for non-payment of six months' rent and the common law right to rescind a lease for material breach.

(c) To the extent that any term in a lease provides that the lease will come to an end automatically or is to be null and void or is to be irritated or subject to irritancy on a breach by the tenant or the occurrence of any other event that term should have effect as though it were a provision giving the landlord an option to terminate the lease.

(d) The occurrence of an event in this context does not include the arrival of the ish or a break in the lease.

(Paragraph 3.21)

9. A landlord should not be permitted to serve a notice of termination based on a remediable breach unless the tenant has failed to remedy the breach after having been given a written warning of the landlord's intention to terminate the lease and an opportunity to remedy the breach.

(Paragraph 3.25)

10. A remediable breach should include both the breach of an obligation that should have been performed by a date that has passed and a continuing breach which can be remedied for the future.

(Paragraph 3.27)

11. (a) The time that a landlord requires to give a tenant to remedy a breach of a monetary obligation should not be less than 28 days or any longer period allowed for payment under the lease or otherwise.

(b) The time allowed in the warning notice to remedy the breach may be extended by agreement between the landlord and tenant at any time prior to the date of service of the notice of termination.

(Paragraph 3.31)

12. (a) The time that a landlord requires the tenant to remedy a non-monetary breach should not be less than 28 days or any longer period allowed to remedy the breach under the lease or otherwise.

(b) The time allowed in the warning notice to remedy the breach may be extended by agreement between the landlord and tenant at any time prior to the date of service of the notice of termination.

(c) At any time within the period of 28 days from the service of the warning notice the tenant should be entitled to seek an extension of the time allowed in the notice from the court on the ground that it is unreasonably short.

(d) At any time before the expiry of the time allowed in the warning notice, where the tenant has substantially performed the obligation in issue but requires a further period of time to complete performance, an extension of the time allowed may be obtained on application to the court.

(e) Where the time allowed has been extended, any reference to the time allowed by the warning notice is a reference to the time as so extended.

(f) The powers of the Land Court to modify a tenant's obligations in relation to fixed equipment under section 66 of the Agricultural Holdings (Scotland) Act 1991 should be available to modify the requirements of a warning notice served in respect of a breach of such obligations, but not so as to reduce the statutory minimum period.

(Paragraph 3.41)

13. (a) Where the rights of the tenant under a lease may be assigned, an option to terminate a lease on account of an insolvency event affecting the tenant should not be exercisable unless the tenant's insolvency practitioner has been offered a suspension of the exercise of the option to terminate for a specified period by way of a moratorium notice.

(b) For this purpose, an insolvency event affecting the tenant means the tenant's insolvency or apparent insolvency or any event which results in the appointment of an insolvency practitioner.

(c) For this purpose, an insolvency practitioner means a person who, in relation to the tenant, acts or is entitled to act as an insolvency practitioner under section 388 of the Insolvency Act 1986.

(d) Where there is an insolvency event affecting the tenant but there is no insolvency practitioner, the tenant should be offered a suspension of the exercise of the option to terminate for a specified period by way of a moratorium notice.

(Paragraph 3.48)

14. For this purpose, a lease is capable of being assigned only if it can be assigned without the consent of the landlord or the landlord does not have an absolute veto in respect of any necessary consent to the assignment.

(Paragraph 3.50)

15. (a) The moratorium notice should be served on the tenant and the tenant's insolvency practitioner.

(b) The moratorium notice should give a warning of the landlord's intention to terminate the lease and offer the insolvency practitioner a period of time in which to attempt to assign the lease before termination can occur.

(c) The offer of a moratorium should be open for acceptance by the tenant's insolvency practitioner for a period of 28 days.

(d) If (i) the offer is not accepted within that period or (ii) the offer is so accepted but the moratorium expires without the tenant's rights under the lease having been assigned, the landlord may proceed to serve a notice of termination founded upon the insolvency event.

(e) The moratorium should not be less than the longer of:

(i) a period of 6 months after the 28 days allowed for acceptance of the offer of the moratorium; or

(ii) any longer period allowed in the lease.

(f) The moratorium period should be capable of being extended either:

(i) at any time before the date of service of a notice of termination, by agreement between the landlord and the insolvency practitioner; or

(ii) at any time before the expiry of the period allowed in the moratorium notice, by the court where it is satisfied that the landlord has either (a) breached an obligation relating to consent to an assignment of the lease; or (b) has otherwise caused unreasonable delay in relation to such consent.

(Paragraph 3.55)

16. Where a moratorium has been accepted:

(a) the landlord's right to terminate the lease on account of any breach of the tenant's obligations or on the occurrence of any event other than the relevant insolvency event is unaffected;

- (b) any warning notice served during that period, or any subsequent notice of termination, should be served on both the tenant and the insolvency practitioner;
- (c) the insolvency practitioner should be entitled to exercise the tenant's rights in relation to any such notice;
- (d) the insolvency practitioner should not thereby incur any liability for any of the tenant's obligations nor be taken to have adopted the lease.

(Paragraph 3.58)

17. (a) Where an option to terminate arises in respect of (i) a breach that is not remediable or (ii) any other event, not being an insolvency event affecting the tenant under an assignable lease, the lease should not be terminated unless the landlord serves a notice of termination on the tenant.

(b) When the tenant has been served with such a notice of termination, he should be able to apply to the court to declare the notice ineffective or to postpone its effect on the ground that the termination of the lease would be a manifestly excessive response to the breach or other triggering event.

(c) The application for relief should be made within 28 days of the service of the notice of termination.

(d) While the application for relief is before the court, the effect of the notice of termination should be suspended.

(Paragraph 3.63)

18. (a) A notice of termination should specify a date upon which the lease is to be terminated.

(b) Where the lease is not an agricultural lease:

(i) when the notice of termination follows a warning notice or a moratorium notice, the date of termination may be no earlier than the date of service of the notice of termination; or

(ii) in any other case, the date of termination may be no earlier than 28 days after the date of service of the notice of termination.

(c) Where the lease is an agricultural lease, the date of termination may be no earlier than 2 months after the service of the notice of termination.

(d) Unless the notice of termination is successfully challenged, the lease will terminate on the specified date.

(Paragraph 3.68)

19. (a) The forms of warning notices, moratorium notices and notices of termination and the explanatory notes that accompany them, should be substantially in the form provided by statute.
- (b) A copy of a warning notice or a moratorium notice or a notice of termination in respect of which no warning notice or moratorium notice was required should be served on qualifying heritable creditors.
- (c) In this context, a qualifying heritable creditor means one who has a right in security over the lease which has been recorded in the General Register of Sasines or registered in the Land Register by a date occurring at least 7 days prior to the date of service of the notice in question.
- (d) Where a warning notice or a moratorium notice was required to be served on a heritable creditor, a copy of any notice of termination following on such a notice should also be served on that creditor.
- (e) Service of notices or copies of notices should be effected by recorded delivery or by sheriff officer and in accordance with any additional requirements stipulated in the lease.
- (f) A notice or copy of a notice should be served at the place stipulated in the lease for the purpose of such service.
- (g) Where no place is stipulated in the lease for the purpose of service, service of a notice or a copy of a notice may be effected by sending the notice to any of the following:-
- the recipient's last business address known to the landlord;
 - the recipient's last residential address known to the landlord; or
 - in the case of a notice addressed to the tenant only, at the subjects of the lease if they have a postal address.
- (h) The date of service of a notice should be the date when it is served if served by a sheriff officer or the day after the date it is posted if service is effected by recorded delivery.
- (i) The tenant or other recipient of a notice should be able to challenge the notice by an application to the court on the ground that the notice is not in accordance with the provisions of the proposed legislation or is otherwise ineffective.
- (j) The fact that a tenant or recipient does not challenge the notice by an application to the court during any period specified in the notice for action to be taken should not prevent it being challenged at a later stage.

(Paragraph 3.75)

20. (a) Except as further provided, any provision of a lease whereby parties contract out or purport to contract out of the proposed legislation should have no effect.
- (b) This does not prevent a tenant who has received a moratorium notice or a notice that the lease is to be terminated for an insolvency event from entering into an agreement with the landlord that the lease is to terminate earlier than would otherwise be allowed under the proposed legislation.

(Paragraph 3.77)

Appendix A

Leases (Scotland) Bill

[Draft]

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Schedule 1—Forms

Schedule 2—Repeals

Leases (Scotland) Bill

[DRAFT]

An Act of the Scottish Parliament to make new provision on the termination of leases by landlords; and for connected purposes.

1 Notice of termination required

- (1) Where a landlord has an option to terminate the lease on a breach by the tenant, or on the occurrence of any other event, the option may be exercised only by the serving of a notice ("a notice of termination") on the tenant in accordance with this Act.
- (2) Subsection (1) applies whether the option is conferred by the lease, by any enactment (including section 15 of this Act) or by any rule of law (including the rule allowing rescission of a contract for material breach).
- (3) To the extent that any term of a lease provides that, on a breach by the tenant or the occurrence of any other event, the lease is to come to an end automatically, or is to be null or void, or is to be irritated or subject to irritancy, that term has effect only to give the landlord an option to terminate the lease on such breach or other event.
- (4) Any reference in this Act to the occurrence of an event does not include the arrival of the ish or a break in the lease.

NOTE

Subsection (1) provides that a landlord can only exercise an option to terminate a lease on account of a breach by the tenant or on the occurrence of any other contractually stipulated event, eg a change in the financial status of the tenant, by serving a notice of termination on the tenant in accordance with the provisions in the Bill. This implements recommendation 8(a). See paragraph 3.19 of the report. The form of a notice of termination is statutorily prescribed: section 10(1) and schedule 1.

Subsection (2) clarifies that the notice of termination is required whether the option to terminate is conferred by the lease, ie by means of a traditional conventional irritancy clause, by any enactment (including the new option to terminate for 6 months' non-payment of rent arising under section 15) or by any rule of law (including the general law of contract which allows a landlord to rescind the lease for the tenant's material breach). This implements recommendations 2, 5(d) and 8(b). See paragraphs 3.6, 3.15 and 3.19 of the report.

Subsection (3), which implements recommendation 8(c), makes clear that the provisions in the Bill apply to any term of a lease, however expressed, which has the effect of allowing the landlord to bring the lease to an end prematurely on the tenant's breach or on the occurrence of any other event. See paragraph 3.19 of the report.

Subsection (4), which implements recommendation 8(d), provides that the arrival of the ish (ie the natural expiry of the lease) or a break in the lease (ie a provision in the lease allowing it to end on a

particular date before the natural expiry of the lease at the option of either party) does not constitute the occurrence of an event and therefore will not trigger any of the controls under the Bill. See paragraph 3.20 of the report.

This section applies to all leases of land, including commercial, agricultural and residential leases: see the definition of "lease" in section 19(1). This implements recommendation 7(a). See paragraph 3.17 of the report.

2 Warning notice required in case of remediable breach

- (1) A notice of termination based on a remediable breach by the tenant may be served only if—
 - (a) the landlord has, in accordance with this Act, served a notice ("a warning notice") on the tenant allowing the tenant time to remedy the breach and warning the tenant that unless the breach is remedied within that time the landlord will have the right to terminate the lease;
 - (b) no application by the tenant under section 3(2) for an extension of the time allowed is before the court; and
 - (c) the tenant has not remedied the breach within the time allowed.
- (2) The time allowed in the warning notice must be not less than—
 - (a) 28 days from the date of service of the warning notice; or
 - (b) if any period remaining between the date of service of the warning notice and the expiry of any time provided in the lease or otherwise for remedying the breach is longer than 28 days, that longer period.

NOTE

This and the following section set out the rules which apply where the landlord has an option to terminate the lease based on a remediable breach. See generally paragraphs 3.24 to 3.42 of the report. "Remediable breach" is defined broadly: see section 19(2). It includes both obligations which can no longer be performed timeously because the date set for performance has passed and continuing breaches which cannot be remedied for the past but which can be remedied for the future. See paragraph 3.26 of the report and recommendation 10.

Subsection (1), which implements recommendation 9, provides that the landlord may not serve a notice of termination on account of a remediable breach unless a warning notice has been served on the tenant. The warning notice informs the tenant of the landlord's intention to terminate the lease and provides the tenant with a reasonable period to remedy the breach. Only where that period has expired without the tenant having complied with its terms can a notice of termination be served. The form of a warning notice is statutorily prescribed: section 10(1) and schedule 1. The period allowed in the notice may be extended by a court in cases of non-monetary breach under section 3(2). Where the tenant has applied for such an extension and the matter is still before the court, the landlord is prevented from serving a notice of termination.

Subsection (2) prescribes the minimum period allowed in the warning notice to remedy the breach. The minimum period is 28 days from the date of service of the warning notice or such longer period as is provided in the lease or otherwise, eg where the period allowed by the lease is

fixed by reference to a separate document such as a statutory repairs notice. This implements recommendations 11(a) and 12(a). See paragraphs 3.30 and 3.35 of the report.

3 Extension of time

- (1) The time allowed in the warning notice may be extended by agreement between the landlord and the tenant at any time prior to the date of service of the notice of termination.
- (2) Where a warning notice is based on a breach of a non-monetary obligation a court, having regard to the nature of the breach, may—
 - (a) on application by the tenant within 28 days after the date of service of the warning notice, extend the time allowed on the ground that it is unreasonably short;
 - (b) on application by the tenant at any time before the time allowed has expired, extend or further extend that time on the ground that the tenant, having substantially performed the obligations specified in the warning notice but having been unable to complete performance, requires a further reasonable period of time to enable performance to be completed.
- (3) Where the time allowed has been extended or further extended under this section, any reference in this Act to the time allowed by the warning notice is a reference to the time as so extended or further extended.

NOTE

This section makes provision for the time allowed in the warning notice to be extended. Save for subsection (1), only the time allowed to perform non-monetary obligations can be extended. See generally paragraphs 3.36 to 3.39 of the report.

Under subsection (1) the parties may agree to an extension at any time prior to date of service of the notice of termination. This implements recommendations 11(b) and 12(b). See paragraphs 3.30 and 3.36 of the report.

In cases of non-monetary breach, subsection (2)(a) allows the tenant to apply to the court for an extension of the time allowed on the ground that it is unreasonably short. The application must be made within 28 days after the date of service of the warning notice. The question before the court is a straightforward objective assessment of what is a reasonable period for compliance with the terms of the notice having regard to the nature of the breach. This implements recommendation 12(c). See paragraphs 3.36 to 3.37 of the report.

Where the tenant has substantially performed the obligations specified in the warning notice but requires a further period of time to comply fully, subsection (2)(b) allows the tenant to apply to the court for an extension. The application must be made before expiry of the time allowed in the warning notice (including any extension of time agreed by the parties or granted by the court). This implements recommendation 12(d). See paragraphs 3.38 to 3.39 of the report.

In the case of agricultural leases, it should be noted that "court" means the Scottish Land Court: section 19(1).

Subsection (3) provides that where the time allowed in the warning notice has been extended, the new period is to be used for the purposes of the Bill. This implements recommendation 12(e).

4 Power to modify requirement in relation to agricultural holdings

- (1) Where, in relation to a tenancy of an agricultural holding within the meaning of the Agricultural Holdings (Scotland) Act 1991 (c.55), a warning notice requires the tenant to remedy a breach of a type mentioned in subsection (1) of section 66 of that Act, the court may, on application by the tenant within 28 days from the date of service of the warning notice, modify the requirement in any of the ways set out in paragraphs (a) to (c) of that subsection.
- (2) A modification under this section may not reduce the time allowed by section 2(2).
- (3) Where a requirement to remedy a breach has been modified under this section, any reference in this Act to the remedying of the breach is a reference to complying with the requirement as so modified.

NOTE

Where a warning notice relates to a tenancy of an agricultural holding under the Agricultural Holdings (Scotland) Act 1991 and the breach is of a type mentioned in section 66(1) of that Act, ie a breach relating to fixed equipment, subsection (1) gives the Scottish Land Court equivalent discretionary powers to those available under that section to modify the requirements in the warning notice. The Court may amend the time allowed to remedy the breach, delete unnecessary or unjustified items from the warning notice or substitute different methods or materials. However, by virtue of subsection (2) the Court is not permitted to reduce the statutory minimum period allowed in the warning notice. The tenant must make an application to the Court for the exercise of such powers within 28 days after the date of service of the warning notice. This implements recommendation 12(f). See paragraph 3.40 of the report.

Subsection (3) provides that where the warning notice has been modified in accordance with this section, the terms of the modified notice apply for the purposes of the Bill.

5 Moratorium to be offered in certain cases of insolvency

- (1) Where a lease is assignable, a notice of termination based on an insolvency event affecting the tenant may be served only if—
 - (a) the landlord has, in accordance with this Act, served on the tenant and the insolvency practitioner a notice ("a moratorium notice") warning of the landlord's intention to terminate the lease and offering the insolvency practitioner a period of time ("the moratorium") in which to attempt to assign the lease; and
 - (b) either
 - (i) the insolvency practitioner has not accepted the offer of a moratorium within 28 days after the date of service of the moratorium notice; or
 - (ii) the insolvency practitioner has accepted the offer and the moratorium has expired without an agreement for the assignation of the lease having been concluded.

- (2) The moratorium offered is to be not less than the longer of—
- (a) 6 months after the expiry of the 28 days allowed for acceptance of the offer;
 - (b) any period allowed by the lease for the lease to be assigned after the occurrence of an insolvency event affecting the tenant.
- (3) Where the offer of a moratorium has been accepted, the length of the moratorium may be extended—
- (a) by agreement between the landlord and the insolvency practitioner at any time prior to the date of service of the notice of termination; or
 - (b) by the court, on application by the insolvency practitioner at any time prior to the expiry of the period allowed, on the ground that the landlord is in breach of an obligation relating to consent to an assignation of the lease or has otherwise caused unreasonable delay in relation to such consent

and, in such a case, any reference in this Act to the moratorium is a reference to the moratorium as so extended.

NOTE

This and the following section set out the rules which apply where the landlord has an option to terminate the lease based on an insolvency event affecting the tenant. See generally paragraphs 3.43 to 3.57 of the report. Insolvency events are defined in section 19(1). These include the tenant's insolvency, apparent insolvency, liquidation, administration and receivership. See paragraphs 3.44 to 3.47 of the report and recommendation 13(b). Since the purpose of the rules is to allow a period free from threat of termination in which to assign the lease, these rules only apply where the lease is assignable. Assignable leases are defined in section 19(1) as leases which may be assigned without the landlord's consent, or where consent has already been given or where the landlord's consent must be obtained but there is no absolute entitlement for that consent to be withheld. See paragraph 3.49 of the report and recommendation 14.

Subsection (1) provides that a landlord may not serve a notice of termination on account of an insolvency event affecting the tenant unless he has first served a moratorium notice on the tenant and the tenant's insolvency practitioner. The moratorium notice warns of the landlord's intention to exercise the right to terminate the lease on account of the insolvency event and offers the insolvency practitioner a reasonable opportunity to assign the lease (the moratorium). The form of the moratorium notice is statutorily prescribed: section 10(1) and schedule 1. The landlord may, however, serve a notice of termination if the insolvency practitioner does not accept the offer of the moratorium within 28 days of service of the moratorium notice or an agreement for the assignation of the lease has not been concluded within the moratorium period. This implements recommendations 13(a) and 15(a) to (d). See paragraphs 3.51 to 3.54 of the report. Insolvency practitioner is defined in section 19(1) and includes permanent and interim trustees, liquidators, administrators and receivers. See paragraph 3.45 of the report and recommendation 13(c). The only insolvency event without a corresponding insolvency practitioner is apparent insolvency. In these circumstances the tenant should be offered the moratorium: see section 6(3).

Subsection (2), which implements recommendation 15(e), prescribes the minimum length of the moratorium. It must be for a period of at least 6 months after expiry of the 28 day acceptance period, or such longer period as is provided in the lease.

Subsection (3), which implements recommendation 15(f), provides that the moratorium may be extended after being accepted by the insolvency practitioner. Subsection (3)(a) provides that the landlord and insolvency practitioner may agree to extend the moratorium at any time prior to the date of service of the notice of termination. Subsection (3)(b) gives the court a discretionary power to extend the length of the moratorium on account of the landlord's breach of an obligation under the lease in relation to an application for consent to the assignation of the lease or where the landlord has otherwise caused unreasonable delay in relation to such an application. This is intended to prevent landlords frustrating the aim of the moratorium by refusing or delaying to respond to an application for consent to an assignation of the lease. See paragraph 3.53 of the report.

6 Further rules on moratorium

- (1) A copy of any notice of termination following on a moratorium notice must be served on the insolvency practitioner.
- (2) During the moratorium—
 - (a) any notice which the landlord is obliged to serve on the tenant must also be served on the insolvency practitioner; and
 - (b) the insolvency practitioner may exercise the tenant's rights in relation to any such notice.
- (3) Where there is an insolvency event affecting the tenant but there is no insolvency practitioner, section 5 and the preceding provisions of this section apply as if references to the insolvency practitioner were references to the tenant, but not so as to require double notice to be served on the tenant.
- (4) Nothing in, or done under, section 5 or this section by itself affects the landlord's right to terminate the lease for any reason other than an insolvency event affecting the tenant.
- (5) Neither the acceptance of the offer of a moratorium nor anything done under this section by itself—
 - (a) imposes liability on the insolvency practitioner for any of the tenant's obligations; or
 - (b) implies that the insolvency practitioner has adopted the lease.

NOTE

This section makes further provision as to the rules which apply in respect of the moratorium. Subsection (1) provides that a copy of a notice of termination relating to an insolvency event for which a moratorium notice was served must be served on the insolvency practitioner.

In order to facilitate the potential assignation of the lease, subsection (2) gives the insolvency practitioner certain of the tenant's rights during the moratorium. Notices under the Bill which

must be served on the tenant should also be served on the insolvency practitioner (eg a warning notice under section 2) and the insolvency practitioner may exercise any of the tenant's rights in relation to such a notice. This implements recommendations 16(b) and (c). See paragraph 3.56 of the report. However, mere acceptance of the moratorium does not by itself impose liability on the insolvency practitioner for any of the tenant's obligations, nor is he to be taken to have adopted the lease: subsection (5). This implements recommendation 16(d). See paragraph 3.56 of the report.

Subsection (3) applies where there is no insolvency practitioner (ie on apparent insolvency of the tenant) and provides that in those circumstances the tenant should be offered the moratorium. See paragraph 3.46 of the report and recommendation 13(d).

Subsection (4), which implements recommendation 16(a), preserves the landlord's right to terminate the lease during the moratorium for any reason other than an insolvency event affecting the tenant (eg for failure to perform a remediable breach) in accordance with the relevant provisions in the Bill. See paragraph 3.57 of the report.

The termination of leases following the occurrence of certain insolvency events may be regulated under the rules of insolvency law. These rules are unaffected by the provisions in the Bill on the moratorium and are specifically reserved. See section 18(1)(b) and paragraphs 1.27 to 1.29 of the report.

7 Notice of termination following on warning notice or moratorium notice

- (1) A notice of termination following on a warning notice or a moratorium notice must specify a date ("the specified date") when the termination is to take effect.
- (2) Where the lease is not an agricultural lease the specified date must be not earlier than the date of service of the notice of termination on the tenant.
- (3) Where the lease is an agricultural lease the specified date must be not less than 2 months after the date of service of the notice of termination on the tenant.
- (4) The notice of termination takes effect on the specified date.

NOTE

This section provides that a notice of termination arising as a result of a warning notice or a moratorium notice takes effect on the date specified in the notice. The specified date must be not earlier than the date of service of the notice of termination or in the case of agricultural leases, not earlier than 2 months after that date. This implements recommendation 18. See paragraphs 3.64 to 3.67 of the report. The longer period of notice prior to the requirement to remove for agricultural leases is consistent with the policy outlined in sections 18(6) and (7) of the Agricultural Holdings (Scotland) Act 2003. These sections are rendered obsolete by sections 7(3) and 8(3) and are therefore repealed by virtue of schedule 2 as introduced by section 21.

The form of termination notice is statutorily prescribed: section 10(1) and schedule 1.

8 Termination in other cases

- (1) A notice of termination given in any case where neither a warning notice nor a moratorium notice is required must specify a date ("the specified date") when the termination is to take effect.
- (2) Where the lease is not an agricultural lease the specified date must be not less than 28 days after the date of service of the notice of termination on the tenant.

- (3) Where the lease is an agricultural lease the specified date must be not less than 2 months after the date of service of the notice of termination on the tenant.
- (4) The notice of termination takes effect on the specified date unless otherwise provided under section 9.

NOTE

This and the following section set out the rules which apply where the landlord has an option to terminate the lease and neither a warning notice nor a moratorium notice is required. These rules would apply in cases of non-remediable breach, on the occurrence of an insolvency event affecting the tenant where the lease is not assignable or on the occurrence of a contractually stipulated event which does not amount to an insolvency event affecting the tenant under an assignable lease, eg diligence being done on the tenant's premises or goods. See generally paragraphs 3.59 to 3.62 of the report.

In these circumstances, the notice of termination takes effect on a date which must be specified in the notice, unless an application under section 9 is outstanding. The specified date must be not less than 28 days after the date of service of the notice of termination or in the case of agricultural leases, not less than 2 months after that date. This implements recommendations 17(a) and 18. See paragraph 3.61 of the report.

The form of termination notice is statutorily prescribed: section 10(1) and schedule 1.

9 Powers of court where effect of notice manifestly excessive

- (1) Where a notice of termination is given in any case where neither a warning notice nor a moratorium notice is required, the tenant may, within 28 days from the date of service of the notice, apply to the court under this section.
- (2) On such an application, the court may, if it considers that the termination of the lease on the specified date would, in all the circumstances, be a manifestly excessive response to the breach or other event giving rise to the option to terminate—
 - (a) declare the notice ineffective; or
 - (b) declare that the notice is not to be effective until a date later than the specified date.
- (3) The effect of the notice of termination is suspended so long as an application under this section is before the court.
- (4) Where an application under this section is refused by the court, the notice of termination takes effect on the specified date or on the date of such refusal, whichever is the later.
- (5) If the court, on an application under this section, has declared that the notice of termination is not to be effective until a date later than the specified date, the notice takes effect on the date fixed by the court.

NOTE

This section sets out the circumstances in which a notice of termination served under section 8 can be modified.

Subsection (1) provides that the tenant may apply to the court for a declaration that the termination of the lease would be a manifestly excessive response to the breach or other event triggering the right to terminate. This implements recommendation 17(b). The application must be made within 28 days of service of the notice of termination. This implements recommendation 17(c). If the court considers that termination of the lease would be a manifestly excessive response, it may refuse to allow the termination to proceed or delay the effect of the notice of termination until a date later than the specified date (eg to allow the tenant sufficient time to remove): subsection (2). The notice of termination may not take effect while an application is before the court: subsection (3). This implements recommendation 17(d). Subsections (4) and (5) prescribe when the notice of termination takes effect in cases where the application has been refused and where the court has delayed the effect of the notice. See paragraph 3.62 of the report.

10 Notices and accompanying documents

- (1) Schedule 1 has effect in relation to—
 - (a) the form of the notices required by this Act; and
 - (b) the documents which must accompany such notices.
- (2) The forms in schedule 1 may be modified by the Scottish Ministers by order made by statutory instrument.
- (3) A statutory instrument containing an order under subsection (2) is subject to annulment in pursuance of a resolution of the Parliament.

NOTE

Subsection (1) provides that a notice under the Bill must be in the form prescribed by schedule 1 and accompanied by the appropriate explanatory note. The Scottish Ministers may modify the forms by order made by statutory instrument: subsection (2). Such orders will be subject to negative resolution procedure: subsection (3). This implements recommendation 19(a). See paragraph 3.69 of the report.

11 Service of copy on heritable creditor

- (1) A copy of a warning notice given under section 2, of a moratorium notice given under section 5 or of a notice of termination given under section 8 must be served on each heritable creditor who has an ascertainable right in security over the lease which is to be terminated.
- (2) The right of a heritable creditor is ascertainable for the purposes of this section if, and only if, by a date 7 days prior to the date of service of the notice, the deed creating the right is recorded in the Register of Sasines or the right is registered in the Land Register.
- (3) Where a copy of a warning notice under section 2 or of a moratorium notice under section 5 has been served on a heritable creditor a copy of any notice of termination following on such notice must also be served on that creditor.

NOTE

Subsections (1) and (2), which implement recommendations 19(b) and (c), provide that a copy of the notices listed in subsection (1) must be served on all heritable creditors who have a right in security over the lease which is recorded or registered in the property registers by a date 7 days prior to service of the notice. This covers standard securities, other existing forms of security and would also include any new forms of heritable securities which may be devised in the future. See paragraph 3.72 of the report. Such a heritable creditor must also be served with a copy of any subsequent notice of termination: subsection (3). This implements recommendation 19(d). Failure to serve a copy of a notice in accordance with this section will render the notice ineffective: section 12(6). The provisions in section 12 in relation to service of notices also apply to service of copies of notices on heritable creditors.

12 Service of notices

- (1) A notice under this Act must be served by recorded delivery or by a sheriff officer.
- (2) If the lease contains any provision as to service which—
 - (a) requires something to be done in addition to what is required by subsection (1); or
 - (b) gives an address for postal service of notices,that provision must be complied with.
- (3) A notice posted to a person by recorded delivery is, for the purposes of this Act, sufficiently served on that person if it is posted to that person at the address given in the lease, or otherwise given to the landlord by that person, for postal service of such a notice or, if no such address has been given, if it is posted to that person at any of the following addresses—
 - (a) the person's last business address known to the landlord;
 - (b) the person's last residential address known to the landlord; or
 - (c) if the subjects of the lease have a postal address and the notice is addressed to the tenant, that address.
- (4) The date of service of a notice for the purposes of this Act is—
 - (a) in the case of a notice which is served by a sheriff officer, the date when it is served;
 - (b) in the case of a notice which is sent by recorded delivery in accordance with any provision of this section, the day after the date when it is posted.
- (5) Where service of a copy of a notice is required by this Act, the copy must be served as nearly as may be at the same time as the notice is served.

- (6) If a copy of a notice is not served as required by this Act, the notice is not regarded as having been served in accordance with this Act.

NOTE

This section makes provision as to the service of notices under the Bill. Subsection (1) prescribes the methods by which notices under the Bill must be served. In addition, any further methods of service specified in the lease must also be observed (eg service by e-mail): see subsection (2)(a). This implements recommendation 19(e). See paragraph 3.70 of the report. Subsection (2)(b) provides that any provisions in the lease specifying the place at which notices are to be served must be complied with. This implements recommendation 19(f).

Subsection (3) sets out the requirements for sufficient service. A notice served by recorded delivery will be sufficiently served if posted to the address given in the lease for service or otherwise given to the landlord for that purpose. Where no such address has been provided, the notice will be sufficiently served if posted to either the person's last business or residential address known to the landlord or (where the subjects of let have a postal address and the notice is addressed to the tenant) the subjects of let. (A notice required to be served on an insolvency practitioner or heritable creditor will not be sufficiently served if sent by recorded delivery to the subjects of let since insolvency practitioners and heritable creditors do not necessarily have a connection with the subjects). This implements recommendation 19(g). See paragraph 3.71 of the report.

Subsection (4) defines the date of service. This varies according to the method of service. Service by sheriff officer is effected on the date of service. Service by recorded delivery is effected on the day after the date of posting. This implements recommendation 19(h). See paragraph 3.73 of the report.

Subsection (5) provides that copies of notices required under the Act (eg on heritable creditors by virtue of section 11) must be served as near as possible to the date of service of the actual notice. Subsection (6) provides that failure to serve a copy of a notice in accordance with the Act will render that notice ineffective.

13 Challenge of notice

- (1) The tenant or other recipient of a notice may challenge the notice by an application to the court on the ground that the notice is not in accordance with this Act or is otherwise ineffective.
- (2) Any period allowed for action to be taken by a tenant or other recipient in response to a notice under this Act does not run so long as a challenge to the notice is before the court.
- (3) The fact that a notice has not been challenged by an application to the court during any period specified in the notice for action to be taken does not prevent a challenge at a later stage.
- (4) In deciding whether a notice is in accordance with this Act, any trivial inaccuracy or formal irregularity is to be disregarded if it could not result in prejudice to the tenant or other recipient.

NOTE

Subsection (1), which implements recommendations 3(b) and 19(i), clarifies that a notice may be challenged by an application to the court on both procedural and substantive grounds. See paragraphs 3.8 to 3.9 and 3.74 of the report. Firstly, it may be challenged on the basis that the notice is not in accordance with the provisions in the Bill, eg the statutorily prescribed forms have

not been used. However, minor errors such as spelling mistakes are to be disregarded for this purpose providing the recipient of the notice could not be prejudiced: subsection (4). See paragraph 3.69 of the report and recommendation 19(a). Secondly, the notice may be challenged on the basis that the tenant has a substantive defence open to him, eg personal bar, waiver or that there has been no breach of the lease. All defences, exceptions or grounds for relief not specifically abolished by the Bill are preserved by virtue of section 18(1)(c).

Subsection (2) provides that any period allowed in the notice for action to be taken by the tenant or other recipient of the notice, eg to remedy a breach, does not run so long as a challenge to the notice is before the court.

Subsection (3) provides that the notice can be challenged at any stage in the proceedings, including after it has purported to take effect, eg in a subsequent action for removing. This implements recommendations 3(b) and 19(j). See paragraphs 3.9 and 3.74 of the report.

14 Effect of notice of termination

- (1) Where, under this Act, a notice of termination takes effect on a date it takes effect on the last moment of that date.
- (2) When a notice of termination takes effect under this Act it terminates the lease for the future, except as provided in subsection (2), and does not affect the rights and liabilities that have accrued up to the time of termination.
- (3) The notice of termination does not affect any provisions in the lease on arbitration, compensation or quantification of damages, or any other provisions expressly or impliedly intended to survive termination.

NOTE

This section, which implements recommendation 1, clarifies the effect of a notice of termination. See paragraphs 3.2 to 3.4 of the report. Subsection (1) specifies that where a notice of termination takes effect on a date, it takes effect at the very end of that date. A notice is not retrospective. It terminates the parties obligations under the lease for the future, but does not affect their rights and liabilities that have already accrued up to the time of termination, eg the landlord's right to receive rent up to that date: subsection (2). The termination does not affect any provisions in the lease which are intended to survive termination, eg on arbitration, compensation or quantification of damages: subsection (3).

15 Option to terminate for non-payment of rent

Where a lease does not contain a provision entitling the landlord to terminate the lease for non-payment of rent the landlord has, unless the lease provides otherwise, an option to terminate the lease under this section if 6 months' rent is due and unpaid.

NOTE

This section, which implements recommendation 5(c), creates a new statutory right to terminate the lease in the event of non-payment of 6 months' rent if the lease does not contain a provision entitling the landlord to terminate for non-payment of rent, eg where the lease is unwritten. The parties may contract out of this section. This implements recommendation 5(e). Section 15 replaces the common law legal irritancy of non-payment of rent for 2 years which is abolished by virtue of section 16(2) and the legal irritancies applicable to agricultural leases in respect of non-payment of rent under the codifying Act of Sederunt of 14 June 1913 and section 20 of the

Agricultural Holdings (Scotland) 1991. These are repealed by schedule 2 as introduced by section 21. See paragraphs 3.13 to 3.15 of the report.

The exercise of this option to terminate will be subject to the same regulatory scheme prescribed for a conventional irritancy for the non-payment of rent: section 1(2). This implements recommendation 5(d). See paragraph 3.15 of the report. Therefore, unlike the legal irritancies it replaces, the option to terminate cannot be purged once any period allowed for performance has expired: section 16(3).

16 Abolition of certain common law rules on irritancy

- (1) Any rule of law giving the Court of Session or any other court an equitable power to grant relief to a tenant against the oppressive operation of irritancy is abolished.
- (2) Any rule of law entitling a landlord to terminate a lease by virtue of a legal irritancy in the event of a failure of the tenant to pay the rent due under the lease for a continuous period of 2 years is abolished.
- (3) Any rule of law enabling a tenant to purge an irritancy after it has been incurred, but before decree in an action taken to enforce it, does not apply to an option to terminate which has been effectively exercised by the serving of a notice of termination in accordance with this Act.

NOTE

Subsection (1), which implements recommendation 4, abolishes the common law equitable power of the court to grant relief against the operation of irritancy in cases of oppressive use of the remedy. See paragraph 3.11 of the report.

Subsection (2), which implements recommendation 5(a), abolishes the common law legal irritancy in respect of non-payment of 2 years' rent. It is replaced by the option to terminate for 6 months' non-payment of rent under section 15 in leases which do not contain a conventional right to terminate for non-payment of rent. See paragraphs 3.13 to 3.15 of the report. Subsection (3) clarifies that an option to terminate exercised in accordance with the provisions in the Bill (including the statutory right under section 15) cannot be purged after the period allowed for performance in the warning notice has expired.

17 Anti-avoidance provisions

- (1) Except as otherwise provided in this Act, any provision of a lease whereby the parties contract out, or purport to contract out, of any provision of this Act is of no effect.
- (2) Subsection (1) does not prevent a tenant who has received a moratorium notice or a notice that the lease is to be terminated for an insolvency event affecting the tenant from entering into an agreement with the landlord that the lease is to terminate earlier than would otherwise be allowed under this Act.
- (3) In applying this Act regard is to be had to the substance of the matter even if the lease has been so drafted as to make it appear that a termination is not the result of the exercise by the landlord of an option to terminate or of a particular type of option to terminate.

NOTE

Subsection (1) prevents the parties from contracting out, or purporting to contract out, of any of the provisions of the Bill, except as otherwise provided. This implements recommendation 20(a).

See paragraph 3.76 of the report. Save for subsection (2), the only provision which may be contracted out of is the option to terminate for non-payment of 6 months' rent in section 15. This implements recommendation 5(e). See paragraphs 3.15 and 3.76 of the report.

In cases of an insolvency event affecting the tenant, subsection (2) allows the tenant to enter into an agreement with the landlord after the insolvency event has occurred enabling the lease to be terminated at an earlier date than would otherwise be permitted under the Bill. This may be of value to the tenant where it transpires after acceptance of the moratorium that an assignation of the lease will not be forthcoming and the tenant wishes to terminate his obligations under the lease as soon as possible. This implements recommendation 20(b). See paragraph 3.76 of the report.

Subsection (3) prevents the provisions of the Bill being avoided by adroit draftsmanship. In applying the provisions of the Bill, regard should be had to the substance and not merely the form of the matter.

18 Saving and transitional provisions

- (1) Nothing in this Act—
 - (a) enables a lease to be terminated by notice in any case where it could not be so terminated in the absence of this Act;
 - (b) enables a notice of termination to be given without the permission of a court or the consent of any person in any case where such permission or consent is required by virtue of any enactment;
 - (c) prevents a tenant from relying on any defence, exception or ground for relief not specifically abolished by this Act.
- (2) Nothing in this Act, apart from the repeals in schedule 2, affects a landlord's rights to take court proceedings to have a tenant removed.
- (3) Nothing in this Act affects any irritancy notice, or any intimation of rescission for material breach, given before the Act comes into force.
- (4) Any reference in any enactment passed or made before this Act comes into force to the irritancy of a lease includes a reference to the termination of the lease by a notice of termination under this Act.

NOTE

Subsection (1)(a) prevents a lease being terminated by virtue of this Bill when as a consequence of other legislation it could not be so terminated. Thus, for example, it preserves any protections afforded tenants of residential leases by the Rent Acts or Housing Acts. This implements recommendation 7(b). See paragraph 3.17 of the report.

Subsection (1)(b) prevents the landlord from serving a notice of termination without the permission of the court or consent of any other person where this is required by virtue of any enactment, eg under the Insolvency Act 1986 or the Enterprise Act 2002. See paragraphs 1.24 to 1.30 and 3.57 of the report.

Subsection (1)(c) preserves all defences, exceptions or grounds for relief available to the tenant not specifically abolished by the Bill, eg the defences of personal bar or waiver. This implements recommendation 3(a). See paragraphs 3.8 to 3.9 of the report.

Subsection (2) preserves the landlord's right to take court proceedings to have a tenant removed. Such proceedings will still remain necessary to recover possession where the tenant does not vacate the property following service of a notice of termination.

Subsection (3) provides that any irritancy notice or intimation of rescission given before the Bill comes into force will be governed by the existing law and any given thereafter will be governed by the provisions in the Bill.

Subsection (4) clarifies that any reference to irritancy in existing enactments (eg the Enterprise Act 2002) includes a reference to termination of the lease by a notice of termination under the Bill.

19 Interpretation

(1) In this Act, unless the contrary intention appears—

"agricultural lease" means a lease under which there is—

(a) a tenancy of an agricultural holding within the meaning of the Agricultural Holdings (Scotland) Act 1991 (c.55);

(b) a short limited duration tenancy under the Agricultural Holdings (Scotland) Act 2003 (asp 11); or

(c) a limited duration tenancy under the Agricultural Holdings (Scotland) Act 2003 (asp 11);

"assignable" in relation to a lease means assignable by the tenant—

(a) without the landlord's consent;

(b) with the landlord's consent, in any case where that consent has been given in advance in the lease or otherwise; or

(c) with the landlord's consent, in any case where the landlord's right to refuse consent to the assignation is not absolute.

"breach" in relation to a tenant means a breach of the tenant's obligations under the lease;

"court" means—

(a) in relation to an agricultural lease, the Scottish Land Court; and

(b) in relation to any other lease, the Court of Session or a sheriff;

"insolvency event affecting the tenant" means the tenant's insolvency or apparent insolvency or any event which results in the appointment of an insolvency practitioner;

"insolvency practitioner" means a person who, in relation to the tenant, acts or is entitled to act as an insolvency practitioner within the meaning of section 388 of the Insolvency Act 1986 (c.45);

"landlord" means the person who is currently the landlord in the legal relationship constituted by the lease, whether or not that person appears as owner of the subjects of the lease in the Register of Sasines or the Land Register;

"lease" means a lease of land and includes any agreement between the landlord and the tenant containing additional or collateral terms relating to the lease;

"monetary obligation" means an obligation to pay rent or any other sum of money under the lease, and "non-monetary obligation" has a corresponding meaning;

"moratorium notice" has the meaning given in section 5(1)(a); and

"warning notice" has the meaning given in section 2(1)(a).

(2) For the purpose of this Act "remediable breach" means any breach, not being an insolvency event affecting the tenant, which is—

(a) a breach of a monetary obligation under the lease; and

(b) a breach of any other obligation under the lease if the breach is capable of being remedied

and a breach does not cease to be remediable merely because the time by which the obligation should have been performed has passed or, in the case of a continuing breach which can be remedied for the future, there has been a period during which there was a breach.

NOTE

Subsection (1) gives the definitions of certain terms used in the Bill. The principal definitions have been described above in the notes to the sections to which they relate. The definition of "landlord" should also be noted. This provides that in order to be entitled to serve notices etc under the Bill a landlord need not be infeft. This definition includes mid-landlords. Subsection (2) defines remediable breach. This implements recommendation 10. See paragraph 3.26 of the report. It should be noted that the definition of remediable breach does not include insolvency events affecting the tenant.

20 Amendments of Agricultural Holdings (Scotland) Acts

(1) In the Agricultural Holdings (Scotland) Act 1991 (c.55), in subsection (2) of section 61 (arbitrations) as substituted by section 76 of the Agricultural Holdings (Scotland) Act 2003 (asp 11)—

(a) the word "or" at the end of paragraph (a) is omitted; and

(b) immediately after paragraph (a) there is inserted—

"(aa) in pursuance of the Leases (Scotland) Act 2003; or".

(2) In the Agricultural Holdings (Scotland) Act 2003 (asp 11), in subsection (2) of section 78 (agreement to refer matters to arbitration)—

(a) the word "or" at the end of paragraph (a) is omitted; and

(b) immediately after paragraph (a) there is inserted—

"(aa) in pursuance of the Leases (Scotland) Act 2003; or".

NOTE

This section makes consequential amendments to the Agricultural Holdings (Scotland) Acts 1991 and 2003. It provides that any disputes concerning the subject matter of this Bill are to be added to the list of matters under these Acts which are specifically reserved to the jurisdiction of the Land Court and cannot therefore be referred to arbitration or other competent means of determination. Subsection (1) amends the 1991 Act in respect of tenancies of agricultural holdings under the 1991 Act and subsection (2) amends the 2003 Act in respect of tenancies under that Act.

21 Repeals

The enactments set out in column 1 of schedule 2 are repealed to the extent specified in column 2 of that schedule.

NOTE

This section introduces schedule 2 which lists the repeal of other enactments consequential upon the provisions of the Bill.

22 Short title and commencement

(1) This Act may be cited as the Leases (Scotland) Act 2003.

(2) This Act comes into force at the end of the period of three months beginning with the date of Royal Assent.

NOTE

Subsection (1) gives the short title of the Bill. Subsection (2) provides that it will come into force 3 months after it is given Royal Assent.

SCHEDULE 1

(introduced by section 10)

FORMS

Part 1 - General

- 1 A notice under this Act must be in one of the following forms (adapted under paragraphs 3 or 4 if necessary) and must be accompanied by the explanatory notes set out below the form.
- 2 The words in italics in the forms and notes are not part of the forms or notes but instructions for their completion.
- 3 In a case where the landlord finds on more than one type of breach or event the forms may be adapted accordingly.
- 4 The forms may also be adapted to the extent necessary to meet any special circumstances not covered by them, but not so as to deprive the recipient of fair notice of the subject matter.
- 5 For identification of the subjects of a lease, a brief description or postal address is sufficient unless that would give rise to a risk of confusion.

Part 2 - Styles

Form A - Warning notice for use in relation to monetary breaches

WARNING NOTICE

LEASE MAY BE TERMINATED

UNLESS PAYMENT IS MADE

1. This notice is given by *[insert name of landlord]* ("the landlord") to you *[insert name of tenant]* as tenant under the lease of *[identify subjects]* between *[identify the parties]* dated *[insert date or dates]*. *[If necessary, add further particulars to identify the documents comprising the lease.]*

2. The landlord gives formal warning that unless the sum of *[state sum due including VAT if applicable]* being *[state nature of sum e.g. rent, service charge, insurance premium or other sum due under the lease. If "other sum", state nature of sum and provision of lease under which it is due.]* is paid by the end of *[state the date by which payment is required, being a date not less than (a) 28 days after the date of service of the notice or (b) such longer period after the date of service of the notice as may still be available for late payment under the lease or otherwise]* the landlord will have the right under *[refer to the source of the landlord's right e.g. the relevant provision of the lease or section 15 of this Act or the law on rescission for material breach]* to terminate the lease by service of a notice of termination. *[If the permission of a court or the consent of any person is, by virtue of any enactment, required for the exercise of the right to terminate, refer to that enactment and state that the exercise of the landlord's right is conditional on that permission or consent being obtained.]*

3. Payment should be made to *[state clearly to whom and where payment should be made]*.

4. Any queries about this notice may be addressed to *[give adequate contact details for landlord or landlord's agent]*.

[To be signed by or on behalf of landlord]

[Date]

Explanatory notes

(Note. These notes are not part of the notice and have no legal effect. They are for information only.)

1. By law a landlord must give a warning notice before exercising an option to end the lease for non-payment of rent or non-payment of any other sum due under the lease. The law is set out in the Leases (Scotland) Act 2003.

2. If payment is not made as required by the notice, this warning notice may be followed by another notice (called a "notice of termination") from the landlord which will bring the lease to an end on the date specified in the notice of termination. *[In the case of an agricultural lease substitute "after a further period of not less than 2 months" for "on the date specified in the notice of termination".]* The landlord may then, if necessary, take steps to have you removed. *[If the permission of a court or the consent of any person is, by virtue of any enactment, required for the exercise of the right to terminate, mention that fact here.]*

3. Section 11 of the Leases (Scotland) Act 2003 requires a copy of this notice to be served on any heritable creditor who has an ascertainable right in security over the lease.

4. You can challenge this notice in a court if you think it is not in accordance with the Leases (Scotland) Act 2003 or is otherwise ineffective. *[If the lease is an agricultural lease substitute "the Scottish Land Court" for "a court".]*

5. You are strongly advised to seek immediate legal advice about this notice.

Form B - Warning notice for use in relation to remediable non-monetary breaches

WARNING NOTICE

LEASE MAY BE TERMINATED

UNLESS BREACH IS REMEDIED

1. This notice is given by *[insert name of landlord]* ("the landlord") to you *[insert name of tenant]* as tenant under the lease of *[identify subjects]* between *[identify the parties]* dated *[insert date or dates]*. *[If necessary, add further particulars to identify the documents comprising the lease.]*

2. The landlord gives formal warning that unless the breach, more fully described in paragraph 3, of your obligations under *[state relevant provision of lease]* is remedied by the end of *[state the date by which the breach must be remedied, being a date not less than (a) 28 days after the date of service of the notice or (b) such longer period after the date of service of the notice as may still be available for remedying the breach under the lease or otherwise]* the landlord will have the right under *[refer to the source of the landlord's right e.g. the relevant provision of the lease or the law on rescission for material breach]* to terminate the lease by service of a notice of termination. *[If the permission of a court or the consent of any person is, by virtue of any enactment, required for the exercise of the right to terminate, refer to that enactment and state that the exercise of the landlord's right is conditional on that permission or consent being obtained.]*

3. *[Describe clearly the remediable non-monetary breach which must be remedied.]*

4. You may apply to a court for an extension of the period mentioned in paragraph 2 if you think that it is unreasonably short. *[If the lease is an agricultural lease substitute "the Scottish Land Court" for "a court".]* Such an application must be made before the end of *[insert date 28 days after the date of service of the notice]*.

5. If you try to remedy the breach as required by this notice and substantially do so but find that you are unable to do so completely within the time allowed and require a further reasonable period of time to enable you to complete performance, you may apply to a court for an extension or further extension of the time allowed. *[If the lease is an agricultural lease substitute "the Scottish Land Court" for "a court".]* Such an application must be made before the time allowed expires. If the time has already been extended you have until the end of the extended time to make the application.

6. Any queries about this notice may be addressed to *[give contact details for landlord or landlord's agent]*.

[To be signed by or on behalf of landlord]

[Date]

Explanatory notes

(Note. These notes are not part of the notice and have no legal effect. They are for information only.)

1. By law a landlord must give a warning notice before exercising an option to end the lease for a remediable breach of the tenant's obligations under the lease. The law is set out in the Leases (Scotland) Act 2003.
2. If you do not remedy the breach as required by the notice, this warning notice may be followed by another notice (called a "notice of termination") from the landlord which will bring the lease to an end on the date specified in the notice of termination. *[In the case of an agricultural lease substitute "after a further period of not less than 2 months" for "on the date specified in the notice of termination".]* The landlord may then, if necessary, take steps to have you removed. *[If the permission of a court or the consent of any person is, by virtue of any enactment, required for the exercise of the right to terminate, mention that fact here.]*
3. Section 11 of the Leases (Scotland) Act 2003 requires a copy of this notice to be served on any heritable creditor who has an ascertainable right in security over the lease.
4. You can challenge this notice in a court if you think it is not in accordance with the Leases (Scotland) Act 2003 or is otherwise ineffective. You also have the special rights mentioned in paragraphs 4 and 5 of the notice to apply to a court for an extension or further extension of the period. *[If the lease is an agricultural lease substitute "the Scottish Land Court" for "a court" in this paragraph.]*
5. Before going to court you may wish to consider asking the landlord to agree to a voluntary variation of the period. But remember that you only have a limited time to apply to the court.
6. You are strongly advised to seek immediate legal advice about this notice.

Form C - Moratorium notice for use in relation to an insolvency event affecting the tenant of an assignable lease where there is an insolvency practitioner

MORATORIUM NOTICE

LEASE MAY BE TERMINATED

FOR AN INSOLVENCY EVENT

1. This notice is given by *[insert name of landlord]* ("the landlord") to you *[insert name of tenant]*, as tenant under the lease of *[identify subjects]* between *[identify the parties]* dated *[insert date or dates]*. *[If necessary, add further particulars to identify the documents comprising the lease].*
2. The notice is also sent to you *[insert name and address of insolvency practitioner who acts or is entitled to act in relation to the tenant]* in your capacity as *[mention capacity (e.g. receiver or liquidator) in which insolvency practitioner is acting]*.

3. The landlord gives formal warning of an intention to terminate the lease under *[state provision of lease giving right to terminate for insolvency event]* on the ground that *[state occurrence of insolvency event giving right to terminate]*.

4. As required by section 5 of the Leases (Scotland) Act 2003 the landlord offers you *[insert name of insolvency practitioner]* a period of time ("the moratorium") until the end of *[insert date not less than six months from the date 28 days after the date of service of this notice, or insert such later date as may be required under the lease]* to enable you to attempt to assign the lease in accordance with the provisions of the lease and the general law on assignments of leases.

5. The offer of a moratorium is open for acceptance by you *[insert name of insolvency practitioner]* in writing reaching the landlord or the landlord's agent within 28 days from the date of service of this notice. If the offer is not accepted within that time the landlord will have the right to terminate the lease by service of a notice of termination. *[If the permission of a court or the consent of any person is, by virtue of any enactment, required for the exercise of the right to terminate, refer to that enactment and state that the exercise of the landlord's right is conditional on that permission or consent being obtained.]*

6. The acceptance should be sent to *[insert name and address of landlord or landlord's agent]*. Any queries about this notice may be addressed to *[give contact details for landlord or landlord's agent]*.

7. The acceptance of the offer of the moratorium does not impose any liability on *[insert name of insolvency practitioner]* for the tenant's obligations under the lease.

8. If the offer of a moratorium is accepted but the moratorium expires without an agreement to assign the lease having been concluded, the landlord will have the right to terminate the lease as set out in paragraph 5.

9. If you *[insert name of insolvency practitioner]*, have accepted the offer of a moratorium, you may apply to a court for an extension of the period allowed, on the ground—

(a) that the landlord is in breach of a requirement of the lease relating to an application for consent to an assignment of the lease; or

(b) that the landlord has caused unreasonable delay in relation to such consent.

[If the lease is an agricultural lease substitute "the Scottish Land Court" for "a court".]

10. An application to the court on one of the grounds mentioned in paragraph 9 must be made before the expiry of the moratorium.

11. The offer or allowance of the moratorium does not affect any right of the landlord to terminate the lease on any ground other than the one mentioned in paragraph 3.

[To be signed by or on behalf of landlord]

[Date]

Explanatory notes

(Note. These notes are not part of the notice and have no legal effect. They are for information only.)

1. By law a landlord must give a moratorium notice before exercising an option to end the lease for an "insolvency event affecting the tenant" (e.g. the tenant's bankruptcy or liquidation).
2. The notice is sent to both the tenant and whoever is handling the tenant's affairs in the insolvency (e.g. a receiver or liquidator or other "insolvency practitioner") but its main purpose is to give the insolvency practitioner a chance to assign the lease. The law is set out in the Leases (Scotland) Act 2003.
3. If the offer of a moratorium is not accepted by the insolvency practitioner within 28 days this moratorium notice may be followed by another notice (called a "notice of termination") from the landlord which will bring the lease to an end on the date specified in the notice of termination. *[In the case of an agricultural lease substitute "after a further period of not less than 2 months" for "on the date specified in the notice of termination".]* The landlord may then, if necessary, take steps to have the tenant removed. *[If the permission of a court or the consent of any person is, by virtue of any enactment, required for the exercise of the right to terminate, mention that fact here.]*
4. The tenant or the insolvency practitioner can challenge this notice in a court if they think it is not in accordance with the Leases (Scotland) Act 2003 or is otherwise ineffective. *[If the lease is an agricultural lease substitute "the Scottish Land Court" for "a court".]*
5. The insolvency practitioner also has the special rights mentioned in paragraph 9 of the notice to apply to the court for an extension of the moratorium.
6. Section 11 of the Leases (Scotland) Act 2003 requires a copy of this notice to be served on any heritable creditor who has an ascertainable right in security over the lease.
7. You are strongly advised to seek immediate legal advice about this notice.

Form D - Moratorium notice for use in relation to an insolvency event affecting the tenant of an assignable lease where there is no insolvency practitioner

MORATORIUM NOTICE

LEASE MAY BE TERMINATED

FOR AN INSOLVENCY EVENT

1. This notice is given by *[insert name of landlord]* ("the landlord") to you *[insert name of tenant]* as tenant under the lease of *[identify subjects]* between *[identify the parties]* dated *[insert date or dates]*. *[If necessary, add further particulars to identify the documents comprising the lease.]*

2. The landlord gives formal warning of an intention to terminate the lease under *[state provision of lease giving right to terminate for insolvency event]* on the ground that *[state occurrence of insolvency event giving right to terminate]*.

3. As required by section 5 of the Leases (Scotland) Act 2003 the landlord offers you a period of time ("the moratorium") until the end of *[insert date not less than six months from the date 28 days after the date of service of this notice, or insert such later date as may be required under the lease]* to enable you to attempt to assign the lease in accordance with the provisions of the lease and the general law on assignments of leases.

4. The offer of a moratorium is open for acceptance by you in writing reaching the landlord or the landlord's agent within 28 days from the date of service of this notice. If the offer is not accepted within that time the landlord will have the right to terminate the lease by service of a notice of termination.

5. The acceptance should be sent to *[give name and address of landlord or landlord's agent]*. Any queries about this notice may be addressed to *[give contact details for landlord or landlord's agent]*.

6. If the offer of a moratorium is accepted but the moratorium expires without an agreement to assign the lease having been concluded, the landlord will have the right to terminate the lease by service of a notice of termination.

7. You may apply to a court for an extension of the moratorium if—

(a) the landlord is in breach of a requirement of the lease relating to an application for consent to an assignment of the lease; or

(b) the landlord has caused unreasonable delay in relation to such consent.

[If the lease is an agricultural lease substitute "the Scottish Land Court" for "a court".]

8. An application to the court on one of the grounds mentioned in paragraph 7 must be made before the expiry of the moratorium.

9. The offer or allowance of the moratorium does not affect any right of the landlord to terminate the lease on any ground other than the one mentioned in paragraph 2.

[To be signed by or on behalf of landlord]

[Date]

Explanatory notes

(Note. These notes are not part of the notice and have no legal effect. They are for information only.)

1. By law a landlord must give a notice (called a "moratorium notice") before exercising an option to end the lease for an insolvency event affecting you (e.g. your bankruptcy). The purpose of the notice is to give you a chance to assign the lease. The law is set out in the Leases (Scotland) Act 2003.

2. If you do not accept the offer of a moratorium within 28 days this moratorium notice may be followed by another notice (called a "notice of termination") from the landlord which will bring the lease to an end on the date specified in the notice of termination. *[In the case of an agricultural lease substitute "after a further period of not less than 2 months" for "on the date specified in the notice of termination".]* The landlord may then, if necessary, take steps to have you removed.
3. Section 11 of the Leases (Scotland) Act 2003 requires a copy of this notice to be served on any heritable creditor who has an ascertainable right in security over the lease.
4. You can challenge this notice in a court if you think it is not in accordance with the Leases (Scotland) Act 2003 or is otherwise ineffective. *[If the lease is an agricultural lease substitute "the Scottish Land Court" for "a court".]*
5. You also have the special rights mentioned in paragraph 7 of the notice to apply to the court for an extension of the moratorium.
6. You are strongly advised to seek immediate legal advice about this notice.

Form E - Notice of termination for use in case of a remediable breach (whether the breach is of a monetary or non-monetary obligation)

**NOTICE OF TERMINATION
OF LEASE**

1. This notice is given by *[insert name of landlord]* ("the landlord") to you *[insert name of tenant]* as tenant under the lease of *[identify subjects]* between *[identify the parties]* dated *[insert date or dates]*. *[If necessary, add further particulars to identify the documents comprising the lease.]*
2. In the Warning Notice dated *[insert date]* (a copy of which is attached to this notice) the landlord gave you notice of the landlord's right to terminate the lease if you failed to do what was required by that notice within the time allowed. You have failed to do so. *[If the permission of a court or the consent of any person was required under any enactment before the landlord's right to terminate could be exercised, refer to that requirement and state that the permission or consent has been obtained.]* In these circumstances the landlord is allowed by law to terminate the lease.
3. The landlord therefore gives you formal notice that the lease is terminated at the end of *[in the case of an agricultural lease specify a date not less than 2 months after the date of service of the notice: in the case of a lease other than an agricultural lease specify the date of service or a later date]* ("the termination date").
4. One effect of termination of the lease by this notice is that you are no longer entitled to occupy the property after the termination date. The landlord requires you to remove from and vacate the property by the end of the termination date and to deliver the keys (if any) to the property to the address given below.

5. The termination of the lease does not affect the landlord's rights under the lease relating to the period up to the end of the termination date, including in particular the right to rent and any other sums due. The landlord may take such steps as are appropriate to enforce these rights.

6. Any queries about this notice may be addressed to *[give adequate contact details for landlord or landlord's agent or adviser]*.

[To be signed by or on behalf of landlord]

[Date]

Explanatory notes

(Note. These notes are not part of the notice and have no legal effect. They are for information only.)

1. By this notice the landlord brings your lease to an end on the last moment of the termination date specified in paragraph 3 of the notice.

2. The landlord claims that you have not paid what was due under the lease or have not done something else that you were obliged to do under the lease and that this gives the landlord a right to end the lease. The law is set out in the Leases (Scotland) Act 2003. *[If the permission of a court or the consent of any person is, by virtue of any enactment, required for the exercise of the right to terminate, mention that fact here and add that the landlord claims that the necessary permission or consent has been obtained.]*

3. You should already have received a warning notice giving you a chance to pay what was due or otherwise comply with the terms of the lease. If no warning notice was sent this notice is of no effect.

4. Section 11 of the Leases (Scotland) Act 2003 requires a copy of this notice to be served on any heritable creditor who has an ascertainable right in security over the lease.

5. You can challenge this notice in a court if you think it is not in accordance with the Leases (Scotland) Act 2003 or is otherwise ineffective. *[If the lease is an agricultural lease substitute "the Scottish Land Court" for "a court".]*

6. You are strongly advised to seek immediate legal advice about this notice.

Form F - Notice of termination for use in case of insolvency event affecting tenant of an assignable lease

NOTICE OF TERMINATION OF LEASE

1. This notice is given by *[insert name of landlord]* ("the landlord") to you *[insert name of tenant]* as tenant under the lease of *[identify subjects]* between *[identify the parties]* dated *[insert date or dates]*. *[If necessary, add further particulars to identify the documents comprising the lease.]*

2. In the Moratorium Notice dated *[insert date]* (a copy of which is attached to this notice) the landlord gave you notice of the landlord's right to terminate the lease on the basis of an insolvency event affecting you and offered a period of time ("the moratorium") for the lease to be assigned. *[Set out the circumstances now giving rise to a right to terminate - for example, that the offer of a moratorium was not accepted, or that it was accepted but the moratorium expired without an agreement for the assignation of the lease having been concluded. If the permission of a court or the consent of any person was required under any enactment before the landlord's right to terminate could be exercised, refer to that requirement and state that the permission or consent has been obtained.]* In these circumstances the landlord is allowed by law to terminate the lease.

3. The landlord therefore gives you formal notice that the lease is terminated at the end of *[in the case of an agricultural lease specify a date not less than 2 months after the date of service of the notice: in the case of a lease other than an agricultural lease specify the date of service or a later date]* ("the termination date").

4. A copy of this notice is being sent to *[state name and address of insolvency practitioner to whom the moratorium notice was sent]* acting as *[state capacity (e.g. receiver or liquidator) in which insolvency practitioner is acting]*. *[Note. Omit this paragraph if there is no insolvency practitioner acting or entitled to act in relation to the tenant.]*

5. One effect of termination of the lease by this notice is that you are no longer entitled to occupy the property after the termination date. The landlord requires you to remove from and vacate the property by the end of the termination date and to deliver the keys (if any) to the property to the address given below.

6. The termination of the lease does not affect the landlord's rights under the lease relating to the period up to the end of the termination date, including in particular the right to rent and any other sums due. The landlord may take such steps as are appropriate to enforce these rights.

7. Any queries about this notice may be addressed to *[give adequate contact details for landlord or landlord's agent or adviser]*.

[To be signed by or on behalf of landlord]

[Date]

Explanatory notes for tenant

(Note. These notes are not part of the notice and have no legal effect. They are for information only.)

1. By this notice the landlord brings your lease to an end on the termination date specified in paragraph 3 of the notice.

2. The landlord claims that an insolvency event (such as your bankruptcy) specified in the lease has occurred and that this gives the landlord a right to end the lease. The law is set out in the Leases (Scotland) Act 2003.

3. You should already have received a notice (called a "moratorium notice") offering a period of time to arrange for the lease to be dealt with as part of the insolvency proceedings. If no moratorium notice was sent this notice is of no effect. *[If the permission of a court or the consent of any person is, by virtue of any enactment, required for the exercise of the right to terminate, mention that fact here and add that the landlord claims that the necessary permission or consent has been obtained.]*
4. Section 11 of the Leases (Scotland) Act 2003 requires a copy of this notice to be served on any heritable creditor who has an ascertainable right in security over the lease.
5. You can challenge this notice in a court if you think it is not in accordance with the Leases (Scotland) Act 2003 or is otherwise ineffective. *[If the lease is an agricultural lease substitute "the Scottish Land Court" for "a court".]*
6. You are strongly advised to seek immediate legal advice about this notice.

Form G - Notice of termination for use in other cases

NOTICE OF TERMINATION OF LEASE

1. This notice is given by *[insert name of landlord]* ("the landlord") to you *[insert name of tenant]* as tenant under the lease of *[identify subjects]* between *[identify the parties]* dated *[insert date or dates]*. *[If necessary, add further particulars to identify the documents comprising the lease.]*
2. *[Here describe the non-remediable breach or other event giving rise to the option to terminate.]* In these circumstances the landlord has the right under *[state source of landlord's right to terminate e.g. the relevant provision of the lease or the law on rescission for material breach]* to terminate the lease. *[If the permission of a court or the consent of any person was required under any enactment before the landlord's right to terminate could be exercised, refer to that requirement and state that the permission or consent has been obtained.]*
3. The landlord therefore gives you formal notice that the lease will terminate at the end of *[state date of termination, being a date not less than 28 days (or 2 months in the case of an agricultural lease) after the date of service of the notice of termination]* ("the termination date").
4. You have a right under section 9 of the Leases (Scotland) Act 2003 to ask a court to declare this notice ineffective or delay its operation if termination of the lease on the termination date would be a manifestly excessive response to the breach or other event giving rise to the notice. *[If the lease is an agricultural lease substitute "the Scottish Land Court" for "a court".]*
5. An application under section 9 must be made by the end of *[here specify date 28 days after the date of service of the notice]*.
6. One effect of termination of the lease by this notice is that you will no longer be entitled to occupy the property after the termination date. The landlord requires you to remove from and vacate the property by the end of the termination date and to deliver the keys (if any) to the property to the address given below.

7. The termination of the lease does not affect the landlord's rights under the lease relating to the period up to the end of the termination date, including in particular the right to rent and any other sums due. The landlord may take such steps as are appropriate to enforce these rights.

8. Any queries about this notice may be addressed to *[give adequate contact details for landlord or landlord's agent or adviser]*.

[To be signed by or on behalf of landlord]

[Date]

Explanatory notes

(Note. These notes are not part of the notice and have no legal effect. They are for information only.)

1. By this notice the landlord brings your lease to an end on the termination date stated in paragraph 3 of the notice. *[If the permission of a court or the consent of any person is, by virtue of any enactment, required for the exercise of the right to terminate, mention that fact here and add that the landlord claims that the necessary permission or consent has been obtained.]*

2. You have a right to apply to a court to have the notice cut down or its operation delayed if termination of the lease on the termination date is a manifestly excessive response to the breach or other event giving rise to this notice. *[If the lease is an agricultural lease substitute "the Scottish Land Court" for "a court".]*

3. Section 11 of the Leases (Scotland) Act 2003 requires a copy of this notice to be served on any heritable creditor who has an ascertainable right in security over the lease.

4. In addition to the special right mentioned in paragraph 2 above, you can challenge this notice in a court if you think it is not in accordance with the Leases (Scotland) Act 2003 or is otherwise ineffective.

5. You are strongly advised to seek immediate legal advice about this notice.

NOTE

Schedule 1 sets out the form of notices required by the Bill, with accompanying explanatory notes. Paragraph 4 of Part 1 provides that the forms set out in Part 2 can be adapted to cater for any special circumstances providing that the recipient of the notice is not prejudiced.

Forms A and B are the appropriate warning notices to be used in cases of monetary and remediable non-monetary breach respectively. Forms C and D are the appropriate moratorium notices to be used in cases where there is an insolvency practitioner and where there is no insolvency practitioner respectively. Forms E, F and G are the appropriate notices of termination to be used in cases of remediable breach, an insolvency event affecting the tenant under an assignable lease and in all other cases respectively.

SCHEDULE 2

(introduced by section 21)

REPEALS

Enactment	Extent of Repeal
The Codifying Act of Sederunt of 14 th June, 1913	Section 5 of chapter XV of Book L.
The Law Reform (Miscellaneous Provisions) (Scotland) Act 1985 (c.73)	Sections 4 to 7.
The Agricultural Holdings (Scotland) Act 1991 (c.55)	Section 20.
The Agricultural Holdings (Scotland) Act 2003 (asp 11)	Section 18(6) and (7).

NOTE

Schedule 2 lists the repeals of other enactments consequential upon the provisions of the Bill. The Codifying Act of Sederunt of 14th June, 1913 and section 20 of the Agricultural Holdings (Scotland) Act 1991 are both legal irritancies applicable to agricultural leases which are replaced by an option to terminate for 6 months' non-payment of rent under section 15 where no conventional right to terminate for non-payment of rent exists. See paragraphs 3.13 to 3.14 of the report and recommendation 5(b).

Sections 4 to 7 of the 1985 Act regulate the exercise of conventional irritancies in commercial leases. They are repealed and replaced by the regulatory scheme provided by the Bill. See paragraph 3.16 of the report and recommendation 6.

Sections 18(6) and (7) of the 2003 Act provide that a landlord must give the tenant 2 months' notice of any intention to remove the tenant on grounds of irritancy. This policy is adopted by sections 7(3) and 8(3) of the Bill and therefore sections 18(6) and (7) of the 2003 Act are obsolete.

Appendix B

Panel of Legal Practitioners

Mr Hamish Hodge, Solicitor, Edinburgh

Mr Iain Macniven, Solicitor, Glasgow

Mr Sandy Reid, Solicitor, Edinburgh

Professor Robert Rennie, University of Glasgow

Mr David Smith, Solicitor, Edinburgh

Mr Ian Wattie, Solicitor, Edinburgh

Panel of Insolvency Practitioners

Mr Iain Bennet, PricewaterhouseCoopers, Glasgow

Mr Gordon Christie, Christie Griffith Corporate, Glasgow

Mr Blair Nimmo, KPMG, Glasgow

Mr Ian Rankin, PricewaterhouseCoopers, Glasgow

Appendix C

List of consultees who submitted written comments to Discussion Paper No 117

Mr John Allan, Solicitor
Mr J M G Blair, Solicitor¹
Professor Stewart Brymer, Solicitor
Buccleuch Estates Ltd
Mr Allan Collie, Solicitor
Committee of Scottish Clearing Bankers
Ms Joan Devine, Solicitor²
Mr J C Drysdale, Solicitor
Mr A G M Duncan
Faculty of Advocates
Mr Alasdair Fox, Solicitor
Mr Kenneth Gerber, Solicitor
Mr Stephen Giusti, Solicitor
Professor William M Gordon
Mr Keith M Griffiths, Solicitor
Mr Graeme Hawkes, Solicitor
Mr John M Hodge, Solicitor
Mr Hamish Hodge, Solicitor
Mr Nicholas Kilpatrick, Solicitor
Land Securities plc
Law Society of Scotland - Conveyancing Committee
Law Society of Scotland - Rural Affairs Committee
Mr Hamish Lean, Solicitor
Mr Struan Leishman, Solicitor
Mr Angus McAllister, University of Paisley
Mr James McIldowie, Solicitor

¹ On behalf of the agricultural partners at Thomtons.

² Ms Devine circulated a questionnaire to clients of DLA, including landlords, tenants, surveyors, insolvency practitioners and banks, seeking their views in relation to the main proposals in the discussion paper.

Mr WP Mennie, Solicitor
Mr Alan S Menzies, Solicitor
Mr George Morton, Solicitor
Mr Lionel D Most, Solicitor
Ms Heather Nisbet, Solicitor
North Lanarkshire Council
Mr Alfred Phillips
Mr J Gordon Reid QC
Royal Faculty of Procurators in Glasgow
Royal Institution of Chartered Surveyors in Scotland
Scottish Agricultural Arbiters Association
Scottish Land Court
Scottish Landowners' Federation
Scottish Law Agents Society
South Lanarkshire Council
Standard Life Investments³
Mr David A Steel, Solicitor⁴
Mr James Stewart, Solicitor
Mr David Sturrock, Solicitor
Mr Robert Sutherland
Mr Duncan W Thomson, Solicitor
Mr Scott Wortley, University of Strathclyde
WS Society⁵

³ Response compiled with the advice of Dundas & Wilson CS.

⁴ Endorses the response of Mr Hamish Hodge.

⁵ Response drafted by Mr J C Drysdale.

Appendix D

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 E 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 E

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 Property 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 Institution of Chartered Surveyors in Scotland

Royal and Sun Alliance

Scottish Enterprise

South Lanarkshire Council

West Lothian Council