HOUSE OF LORDS SESSION 2005–06
[2005] UKHL 70

on appeal from: [2004] EWCA Civ 1306

OPINIONS

OF THE LORDS OF APPEAL

FOR JUDGMENT IN THE CAUSE

London Diocesan Fund and others and others (Respondents)
v.
Avonridge Property Company Limited (Appellants)

Appellate Committee

Lord Nicholls of Birkenhead
Lord Hoffmann
Lord Scott of Foscote
Lord Walker of Gestingthorpe
Baroness Hale of Richmond

Counsel

Appellants:
Mark Warwick
(Instructed by Philippsohn Crawfords Berwald)

Respondents:
Nathan Wells
(Instructed by Gattas Denfield)

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ON
THURSDAY 1 DECEMBER 2005

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LORD NICHOLLS OF BIRKENHEAD

1. This appeal raises a question on the effect of the Landlord and Tenant (Covenants) Act 1995. A sublease invariably contains a covenant by the lessor to pay the rent due under the head lease. Before the enactment of the 1995 Act a lessor could, by the use of appropriate wording, limit his liability under such a covenant in whatever way he and the subtenant might agree. In particular, the lessor's liability could be restricted to the period while the reversion to the sublease remained vested in him. This was legally possible, if seldom met in practice. When the lessor's liability was confined in this way, and the lessor assigned the reversion, his successor would be liable under this covenant by virtue of privity of estate but the lessor's own liability by virtue of privity of contract would be at an end. The issue on this appeal is whether the 1995 Act precludes a lessor from now limiting his liability in this way. The Court of Appeal held it does: [2005] 1 WLR 236.

2. The context is as follows. In February 2002 Avonridge Property Co Ltd acquired by assignment a lease of seven small shop units at Wealdstone, Middlesex. The lease was for a term of 99 years expiring in 2067, at an annual rent of £16,700 subject to review. Avonridge granted subleases of six of these shops for substantially the same term as its own lease, or head lease as the lease then became. The rent payable under each sublease was a peppercorn. The sublessees paid Avonridge substantial premiums for their subleases, of the order of £75,000 for each sublease.

3. Each sublease contained, in clause 6, a landlord's covenant for quiet enjoyment and for payment of the rent reserved by the head lease. The words of covenant read as follows (commas have been added to assist reading):

> 'The Landlord covenants with the Tenant as follows (but not, in the case of Avonridge Property Company Limited only, so as to be liable after the Landlord has disposed of its interest in the Property) ….'

4. On 2 April 2002 Avonridge assigned the head lease to a Mr Dhirajlal Phithwa. Mr Phithwa was, to use the old legal phrase, a man of straw. He disappeared, leaving unpaid the rent due under the head lease. The head lessor, the London Diocesan Fund and the Parochial Church Council of Holy Trinity, Wealdstone, commenced forfeiture proceedings. The subtenants were granted relief, on unexceptional terms: they had to pay the rent arrears under the head lease with interest and costs, and take new leases of their individual units. The new leases were for the same term as their former subleases and at a rent equal to an apportioned part of the rental payable under the forfeited head lease. This meant that for the future, under the new leases, the former subtenants had to pay an annual rent of £2,376 or, in one instance, £2,441. This is to be contrasted with the nominal rent payable under the subleases they had bought from Avonridge.

5. The subtenants brought proceedings against Avonridge, claiming damages for breach of the landlord's covenant in clause 6 of their leases. Judge Copley sitting in Willesden County Court gave judgment for the subtenants, for damages to be assessed. He held that the 1995 Act rendered void the words in clause 6 limiting Avonridge's liability to the time it was the landlord. The Court of Appeal, comprising Pill, Jonathan Parker and Hooper LJJ, dismissed Avonridge's appeal. Avonridge has now appealed to your Lordships' House.

A trap for the unwary?

6. It must be said at once that Avonridge's case is not overburdened with merit. Indeed, on their face the transactions have the appearance of a scam. The sublessees' security, and the value of their subleases, depended on the strength of the sublessor's covenant to pay the head lease rental. But Avonridge could end its liability to pay this rent at any time. There was, it seems, no restriction on assignment of the head lease. If Avonridge assigned the head lease its liability as tenant of that lease would end automatically, by virtue of section 5 of the 1995 Act. Its liability as landlord under the subleases would also end automatically, by virtue of the limited terms of the landlord's covenant in clause 6 of the subleases.

7. An assignee of the head lease from Avonridge would of course become liable to the head lessor in respect of the tenant's covenants in the head lease. An assignee would also become liable to the sublessees in respect of the landlord's covenant in clause 6 of the subleases. In each instance this liability would arise by virtue of privity of estate. But no one of financial substance would take an assignment of the head lease and thereby incur liability to pay rent of £16,700 per annum to the head lessor, save on payment of a substantial 'reverse' premium. No one would do so, because the property for which this rent was payable was let on correspondingly long subleases yielding no rental income.

8. Thus the overall position was that Avonridge received premiums from the subtenants totalling altogether £458,500 in exchange for subleases which from their inception were essentially valueless. They were valueless because by its own act of assignment to a worthless assignee Avonridge could at any time put the subleases in jeopardy of forfeiture. Avonridge could do this without incurring any liability either to the head lessor or to the subtenants. From the outset it was in Avonridge's financial interest to take this course as soon as possible. Avonridge lost no time in doing so.

9. How these unfortunate sublessees came to acquire and pay for these subleases is not a matter before your Lordships. Nor is the question whether any of the circumstances surrounding these transactions may afford the sublessees redress, whether against Avonridge or others. Your Lordships' House is concerned only with the rights and obligations of the parties under the terms of the subleases they entered into. But the potential use of the provisions of the 1995 Act in the manner illustrated by the facts of this case is a matter to be taken into account when interpreting the statutory provisions.

The 1995 Act

10. The 1995 Act gave effect, with amendments, to the recommendations of the Law Commission in its report 'Landlord and Tenant Law – Privity of Contract and Estate': Law Com No 174 (1988). One of the principal mischiefs the Act was intended to remedy was that, as the law stood, the original tenant of a lease remained liable for performance of the tenant's covenants throughout the entire duration of the lease. A tenant might part with his lease and many years later find himself liable for substantial amounts of unpaid rent, perhaps much

increased under rent review provisions, and for the cost of making good extensive dilapidations.

11. This was considered unfair. This potential liability was not widely understood by tenants, and it could lead to hardship. Section 5 of the Act remedied this defect in the law. Section 5 provides that where a tenant assigns the whole of the premises demised to him under a tenancy, he is released from the tenant covenants of the tenancy. A tenant covenant is a covenant falling to be complied with by the tenant of premises demised by the tenancy. Tenancy includes a sub-tenancy: section 28(1).

12. Section 6 contains a corresponding provision for the benefit of landlords in respect of landlord covenants, but this provision is not so far-reaching in its effect. Unlike the automatic release of tenant covenants brought about by assignment of the whole of the demised premises, assignment of the reversion in the whole of the demised premises does not automatically relieve the landlord from his liability under the landlord covenants. The Law Commission considered the new provision regarding landlord covenants could not mirror precisely the position regarding tenant covenants. Tenants rarely, if ever, have a right to give or withhold consent to dispositions by their landlord. Moreover, there was less need for radical change with landlord covenants because landlords undertake far fewer obligations than tenants, and landlords may not be troubled by the prospect of continuing responsibility: see para 4.16 of its report.

13. So sections 6 to 8 of the Act provide a landlord with a means which may result in his being released from the landlord covenants but will not necessarily do so. If the landlord assigns the whole of the premises of which he is landlord he may apply to be released from the landlord covenants of the tenancy. A landlord covenant is a covenant falling to be complied with by the landlord of the premises demised by a tenancy. An application for release is made by the landlord serving an appropriate notice on the tenant requesting a release of the landlord covenant wholly or in part. Where the landlord makes such an application the covenant is released to the requested extent if the tenant consents, or if he fails to object, or if he does object but the court decides it is reasonable for the covenant to be released: section 8.

14. These statutory provisions might readily be stultified if the parties to a lease could exclude their operation. In particular, the

provision for automatic release of tenant covenants on assignment of a lease would be a weak instrument if it were open to a landlord to provide that the original tenant's contractual liability should continue for the whole term notwithstanding section 5. So the Act, in section 25, enacts a comprehensive anti-avoidance provision. Subsection (1) relevantly provides:

> 'Any agreement relating to a tenancy is void to the extent that-
>
> (a) it would apart from this section have effect to exclude, modify or otherwise frustrate the operation of any provision of this Act, or
>
> (b) it provides for-
>
> (i) the termination or surrender of the tenancy, or
>
> (ii) the imposition on the tenant of any penalty, disability, or liability,
>
> in the event of the operation of any provision of this Act ..'

The words in parenthesis in Avonridge's covenant in clause 6 of each sublease are an 'agreement relating to a tenancy' within the meaning of this section: section 25(4). But does this agreement 'frustrate the operation' of any provision of the Act? That is the key question.

15. The subtenants submit it does. The limited release provisions in sections 6 to 8 were intended to be the sole means whereby an original landlord could obtain a release from the landlord covenants when he assigned the reversion. The parenthetical words in clause 6 would frustrate that statutory purpose if they were allowed to have effect according to their tenor.

16. I am unable to agree. Where I part company with this submission is its statement of the statutory purpose. Sections 5 to 8 are relieving provisions. They are intended to benefit tenants, or landlords, as the case may be. That is their purpose. That is how they are meant to operate. These sections introduced a means, which cannot be ousted, whereby in certain circumstances, without the agreement of the other party, a tenant or landlord can be released from a liability he has assumed. The object of the legislation was that on lawful assignment of a tenancy or reversion, and irrespective of the terms of the tenancy, the tenant or the landlord should have an exit route from his future

liabilities. This route should be available in accordance with the statutory provisions.

17. Thus the mischief at which the statute was aimed was the *absence* in practice of any such exit route. Consistently with this the legislation was not intended to close any *other* exit route already open to the parties: in particular, that by agreement their liability could be curtailed from the outset or later released or waived. The possibility that by agreement the parties may limit their liability in this way was not, it seems, perceived as having unfair consequences in practice, even though landlords normally have greater bargaining power than tenants. So there was no call for legislation to exclude the parties' capacity to make such an agreement, ending their liability in circumstances other than those provided in the Act.

18. Section 25 is of course to be interpreted generously, so as to ensure the operation of the Act is not frustrated, either directly or indirectly. But there is nothing in the language or scheme of the Act to suggest the statute was intended to exclude the parties' ability to limit liability under their covenants from the outset in whatever way they may agree. An agreed limitation of this nature does not impinge upon the operation of the statutory provisions.

19. This is so whether the agreed limitation is included in the lease itself or is in a separate document by way of waiver or agreement to release. The legal effect is the same in each case. Whatever its form, an agreed limitation of liability does not impinge upon the operation of the statutory provisions because, as already noted, the statutory provisions are intended to operate to relieve tenants and landlords from a liability which would otherwise exist. They are not intended to impose a liability which otherwise would be absent. They are not intended to enlarge the liability either of a tenant or landlord. The Act does not compel a landlord to enter into a covenant with his tenant to pay the rent under a head lease. The Act does not compel this, even though it may be eminently reasonable that a landlord should do so. Nor do the statutory restrictions on the circumstances where a landlord can end his liability without his tenant's consent carry any implication that a tenant may not agree to end his landlord's liability in other circumstances. Such an implication would be inconsistent with the underlying scheme of these provisions.

20. This appraisal accords with the thrust of the Law Commission's report. The commission expressly recognised, in paragraph 2.17, that the parties to a lease were able to limit their obligations so that their obligations ended on disposal of their interests:

> 'A lease can, as a matter of bargain, limit the obligations of one or both of the parties, so that they come to an end if the parties transfer their interest in the property. However, this is rarely done.'

A similar view is expressed in paragraph 3.3: the continuing liability of the original parties to leases is a 'matter of contract'. The parties 'are free to vary the normal rule'. This is 'sometimes done, but not frequently'. Nowhere in its report does the commission suggest the parties' freedom to vary the normal rule has given rise to problems and should be curtailed. Had such a fundamental incursion into basic law been intended that would surely have found clear expression in the Act.

21. Nor do the events in this case exemplify a loophole in the Act Parliament cannot have intended. The risks involved were not obscure or concealed. They were evident on the face of the subleases. The sublessees were to pay up-front a capitalised rent for the whole term of the subleases. But clause 6 enabled Avonridge to shake off all its landlord obligations at will. Any competent conveyancer would, or should, have warned the sublessees of the risks, clearly and forcefully.

The Chesterfield case and section 3

22. Attention was drawn to the decisions of Lightman J and the Court of Appeal, comprising Judge and Jonathan Parker LJJ and Bodey J, in *BHP Petroleum Great Britain Ltd v Chesterfield Properties Ltd* [2002] Ch 12 and [2002] Ch 194. By an agreement for a lease the landlord agreed to carry out certain building works. The landlord's obligations were expressed to be personal obligations of the landlord, Chesterfield Properties Ltd. In the agreement the tenant acknowledged it would have no claim against Chesterfield's successors arising out of the landlord's obligations to remedy building works defects. Some time after the lease was granted Chesterfield assigned the reversion to an associated company. Chesterfield served a section 8 notice on the tenant, applying to be released from all 'the landlord's obligations under the tenancy'. The tenant did not serve a counter-notice. In answer to a claim brought

by the tenant against Chesterfield in respect of building works defects Chesterfield asserted it had been released from its obligations by section 8.

23. Both courts rightly held that service of the section 8 notice did not release Chesterfield from its obligation to make good defects. That was a personal obligation and, as such, not a landlord covenant within the meaning of section 28(1) of the 1995 Act. It was not an obligation falling to be complied with by the person for the time being entitled to the reversion: [2002] Ch 194, 211-212, para 59.

24. This decision does not assist the sublessees in the present appeal. Unlike Chesterfield's liability under the lease agreement, Avonridge's liability under clause 6 was expressly limited to the period for which it held the reversion.

25. Reference was also made to section 3 of the Act. I must explain as briefly as possible why this section is irrelevant in the present case. One purpose of the 1995 Act was to abolish the long-established distinction between covenants which 'touch and concern the land' or, in its more modern formulation, covenants having 'reference to the subject-matter of the lease', and those which do not. The former expression derives from *Spencer's case* (1583) 5 Co Rep 16a and the latter from sections 141 and 142 of the Law of Property Act 1925. Generations of conveyancers and law students have been familiar with these phrases and with writers' lists of covenants held by courts to be on one or other side of the line: see, for instance, Megarry and Wade 'The Law of Real Property', 6th edition (2000), pages 955-956. The significance of the distinction was that only covenants satisfying this ancient test 'ran' with the land so that the benefit or burden passed to assignees by virtue of privity of estate.

26. The distinction has long been criticised as illogical and not easily drawn in practice. Section 3 of the 1995 Act, read with section 30(4), abolished this distinction for post-1995 tenancies. In place the Act established a new, self-contained statutory code regulating the transmission of the benefit and burden of landlord and tenant covenants. Under section 3(1) the benefit and burden of all landlord and tenant covenants of a tenancy is annexed to the premises demised by the tenancy and the reversion in them and passes on an assignment of those premises or the reversion. The parties to a lease, however, still remain free to agree that the benefit or burden of a covenant shall not pass on

assignment of the tenancy or reversion. Where a covenant is expressed to be 'personal to any person' section 3 does not make the covenant enforceable by or, as the case may be, against any other person: section 3(6).

27. The covenant in clause 6 does not fall within this 'personal' category. It was intended to endure throughout the term of the sublease and be binding on Avonridge's assigns. So section 3(1) applied to this covenant. But that leads nowhere in the present case, because in clause 6 Avonridge's liability under this covenant is expressly limited to the period while it holds the reversion. Nothing in section 3 precludes the parties from limiting the liability of the original covenantor in this way. Nor is such a limitation rendered void by section 25. This limitation on the duration of the original covenantor's liability does not affect the transmission of the benefit and burden of the covenant in accordance with section 3.

28. For these reasons I would allow this appeal and set aside paragraph 11(d) of Judge Copley's order of 17 December 2003.

LORD HOFFMANN

My Lords,

29. I have had the advantage of reading in draft the speech of my noble and learned friend Lord Nicholls of Birkenhead. For the reasons he gives, with which I agree, I would allow this appeal.

LORD SCOTT OF FOSCOTE

My Lords,

30. I have had the advantage of reading in draft the opinion prepared by my noble and learned friend Lord Nicholls of Birkenhead and for the reasons he has given, with which I am in full agreement, I too would allow this appeal and make the order he has proposed.

LORD WALKER OF GESTINGTHORPE

My Lords,

31. I have the misfortune to differ from my noble and learned friends as to the disposal of this appeal. I shall express my dissent as briefly as possible.

32. Mr Mark Warwick (for the appellant ex-landlord) did not seek to argue that its conduct had been meritorious. In a period of less than two months it acquired the head lease of seven shop units, granted six under-leases at premiums which gave it a profit of the order of £200,000, and then sold the head lease (for £50,000) to Mr Phithwa. Mr Phithwa himself made a profit of over £20,000 (by granting a seventh under-lease at a premium) and then disappeared without ever paying any rent under the head lease. The unfortunate subtenants have had to pay a heavy price to avoid forfeiture (unless and except so far as they may have been able to pass on that burden to their solicitors).

33. My noble and learned friends rightly attach great importance to the general legislative purpose of the Landlord & Tenant (Covenants) Act 1995 ("the Act"). It was to provide for the release from liability of ex-landlords and ex-tenants, not for the imposition of such liability on them. But section 25 of the Act contains a provision against "contracting-out" expressed in wide terms. It applies (by section 25(4)) to an agreement relating to a tenancy whether or not the agreement is contained in the instrument creating the tenancy, or ante-dates it. It seems to me clear that if each of the six subleases had contained a covenant by the tenant to release the landlord from liability after it (the landlord) had disposed of its interest in the demised premises, even though the landlord had not complied with the procedure set out in section 8 of the Act, that covenant would have been struck down by section 25. The landlord would have been using his bargaining power "to exclude, modify or otherwise frustrate" the operation of the Act.

34. I cannot see why a different result should follow just because the contracting-out provision is contained, not in a separate covenant, but in a rather clumsy parenthesis at the beginning of clause 6, which (as is common ground) contains "landlord covenants" within the meaning of the Act. I cannot reconcile this with Mr Warwick's repeated submission

that his case depended on principle, and not on some narrow semantic point.

35. I am driven to the conclusion that although the general legislative purpose of the Act was to effect the release from liability of landlords and tenants on their assignment of their interests, subject to and in accordance with the provisions of the Act, section 25 is expressed in terms wide enough to interfere with the freedom of contract which was available to the parties in negotiating a tenancy before the coming into force of the Act. By restricting the parties' freedom of contract, the Act (in a case such as the present) does operate to make it more difficult for a landlord to escape liability on landlord covenants (within the meaning of the Act). I would accept the submission of Mr Wells, for the respondents, that that can be done only by the procedure laid down in section 8 of the Act. To that limited extent the Act does operate, as it seems to me, to shut off what my noble and learned friend Lord Nicholls of Birkenhead has described as "any other exit route" previously open to the parties.

36. The Law Commission considered this topic very carefully, but there is no indication either in the 1986 working paper (no. 99) or in the 1986 Report on Privity of Contract and Estate (Law Com No 174) that the Law Commission addressed this particular point. In my opinion it has to be answered by construing the language of the Act itself. For my part I would have dismissed this appeal.

BARONESS HALE OF RICHMOND

My Lords,

37. I entirely agree with the reasons given by my noble and learned friend, Lord Nicholls of Birkenhead, for allowing this appeal. I add only a few words because much was made, in the arguments before us and in the courts below, of the recommendations of the Law Commission in their Report on *Privity of Contract and Estate* (Law Com No 174, 1988). As the parties both know, I was a member of the Law Commission, not only at the time of that Report but also when the preceding Working Paper, *Privity of Contract and Estate, Duration of Liability of Parties to Leases* (PWP No 95, 1986) was published, and

thus was party to the Commission's deliberations and recommendations.

38. Both parties to this case sought to draw support from the Law Commission's work. However, it should be borne in mind when reading the Commission's publications that the Commission contemplated that their recommendations would apply to existing as well as to new leases. Thus the Report recommended (Law Com No 174, at para 4.59):

> "The introduction of our proposed scheme would not have any immediate effect on the rights and liabilities of those who were then landlords and tenants, nor those of people who were previously in that position but no longer had any interest in the property in question. Only when the interest of the current landlord or the current tenant changes hands should the proposed rules change the position."

Hence there was no equivalent in the draft Bill annexed to the Law Commission's Report to section 1(1) of the Landlord and Tenant (Covenants) Act 1995, which limits sections 3 to 16 of the Act to new tenancies. The limitation of the Commission's scheme to new tenancies was the result of negotiations with the property industry after the Commission's report.

39. Given that the Commission contemplated that both existing and new tenancies should be covered by their recommendations, they clearly could not have contemplated any change in the existing freedom of the original parties to contract out of any continuing liability once they had parted with their interest in the property. This is confirmed by the reference to that freedom in both the Working Paper (PWP No 95, at para 3.3) and in the Report (Law Com No 174, also at para 3.3). The mischief at which the Commission's recommendations were aimed was the continuation of a liability long after the parties had parted with their interests in the property to which it related. If there was already no continuing liability, because of the express terms of the lease which were apparent to all, there was no mischief.

40. It would, of course, have been open to Parliament, when passing the 1995 Act, to limit the initial landlord's freedom to contract out of any continuing liability. But there is nothing in the 1995 Act which effects such a fundamental change of principle. Given the concerns of

the property industry which led to the modifications of the Law Commission's recommendations, it would have been surprising if there were. The provisions with which we are concerned, principally sections 6 and 8 of the 1995 Act, are closely modelled on those in clauses 4 and 6 of the Bill annexed to the Law Commission's Report (allowing for the stylistic changes which often seem to take place when a new draftsman takes over another's draft). I cannot find in them, or in section 3, which is concerned to identify those covenants which fall within the doctrine of privity of estate and are thus *capable* of running with the tenancy and the reversion, anything to suggest such a radical change in policy.

41. For those reasons, in addition to those given by Lord Nicholls, I too would allow this appeal.