THE HIGH COURT

1986 No.890SS

IN THE MATTER OF THE ARBITRATION ACTS 1954 - 1980

AND IN THE MATTER OF AN ARBITRATION

BETWEEN/

O'MALLEY PROPERTY LIMITED

LESSOR

AND

HYNES LIMITED

LESSEE

Case Stated

Judgment of Mr. Justice Gannon delivered on the 30th day of November 1987.

Mr. John F. Mulcahy F.R.I.C.S. was appointed by the above-named lessor and lessee as Arbitrator pursuant to the provisions of the Arbitration Acts 1954 and 1980 upon a reference of a dispute as provided for in the subparagraphs set out in Clause D 3 of a lease dated 29th March 1972. The interest of the lessor in the property demised by that lease is now vested in O'Malley Property Limited and Hynes Limited are the original lessee. The subject matter of arbitration is the rent payable under the provisions for periodic revision of rent contained in Clause D 3 (ii) 2. The premises as described in the First Schedule to the lease were demised for a term of 99 years from the 1st day of January 1972 the consideration therefor being the rent reserved and covenants on the part of the lessee. The rent reserved was the yearly sum of £42,000 "and such increased rent as may from time to time be payable hereunder as hereinafter provided clear of all deductions (except for landlord's property

tax) by equal quarterly payments in advance". The provisions for increase of rent are contained in the paragraph and subparagraphs numbered D 3. The lease prescribes a procedure for revision of the amount of rent payable thereunder at seven year intervals and under these provisions the rent payable from the 1st of January 1986 fell to be revised. The prescribed notices were served and a dispute arose which was referred for arbitration to Mr. Mulcahy. He has submitted this Case Stated for the advice of the Court.

The questions posed in the Case Stated are as follows:-

"(1) Whether upon the proper construction of the lease and the rent review clause contained in the lease, the market rental value of the premises as of 1 January 1986 should be determined:

(1) on the basis of one or more than one letting of the entire property;

(2) (a) on the basis of vacant possession of the entire or vacant possession of the portions of the demise occupied by the lessee with the portions actually sublet at the review date deemed to be so sublet;

(b) taking into account as a guide the rents recoverable by the lessee from its subtenants or considering such rents to be the limit of the amount of rents to be fixed in relation to those portions of the demise which are so sublet.

(3) taking into account any improvements lawfully made by the lessee (otherwise than in pursuance of an obligation under the lease)."

The following documents are annexed to and incorporated with the Case submitted:

(1) Lease dated 29th March 1972 - Sisk Properties Limited of the one part and Hynes Limited of the other part.

(2) Revised Rent Notice served on the lessees dated 3rd May 1985.

(3) Notice of Dispute served on the lessors dated 9th May 1985.

Neither the facts as found nor the documents indicate the continued existence of the sublettings in the Second Schedule of the lease, nor the making nor terms of any additional subleases, nor the alteration of the premises by "improvements".
It has been agreed by Counsel that portions of the demised premises are in the occupation of lawful subtenants, and that some alterations have been made. Whether such alterations qualify as improvements has not been agreed. It is agreed that while the existence of sublettings is a fact necessary for this case the details thereof are not essential to the issues in dispute. Subsequent to the hearing I have been informed as follows by letter dated the 14th of May 1987.

"This is a joint reply from both offices and signed by both parties.

We will deal with the point of the sublettings first and the improvements secondly.

The premises are presently sublet in part. As can be seen from the lease (Second Schedule) there were six sublettings when the lease was entered into. There are presently ten sublettings.

Regarding the improvements, it is contended in arbitration on behalf of the tenant that there were improvements i.e. the installation in 1976 of a sprinkler system throughout the building and the conversion of the first floor from use by Hynes Limited as a showroom/storage space to office space. It was contended by the landlords that such work did not constitute an improvement or if they did, such improvement did not constitute an allowable improvement. The arbitrator has not made any finding on this issue."

The difficulty giving rise to the Case Stated derives from the fact that the demised premises is lawfully capable of being subdivided and sublet in portions and upon terms and at rents not necessarily coincident with the terms of seven year periods to which the rent reserved under the lease is to be related.

The Arbitrator summarized in the Case Stated the submissions made to him on behalf of the lessors and the lessees as follows:-

"(e) The following submissions were made on behalf of the parties:

(i) The lessee contends that the rent review clause requires the assumption of a single tenant taking a lease of the entire of the

demised premises under one instrument but allows that such tenant may have in mind, and may then actively proceed to sublet the entire of the demised premises in parts.

(ii) The lessee contends that for the purpose of fixing the rent, the building must be considered on the basis that (a) portions of the buildings are sublet at the time of review so that vacant possession is not available to an intending lessee in respect of those portions and (b) the level of rent existing under the subleases should form the limit as to the amount of rent which could be fixed for sublet portions under the headlease.

(iii) The lessee contends that in fixing the rent consideration should be given to all improvements made by it to the building.

(iv) The lessor contends that the rent review clause does not preclude the rental being fixed on the basis of more than one letting of the entire property and that there should not therefore be any requirement to assume a single tenant taking a lease of the entire premises.

(v) The lessor contends that the building must be considered on the basis of (a) vacant possession and (b) that the terms of the existing subleases relating to rent should be regarded as a guide only to the level of rent

which can be obtained in the building and not as a limit upon the rent to be fixed under the headlease.

(vi) The lessor contends that in fixing the rent no consideration should be given to improvements made by the lessee to the building (otherwise than in pursuance of an obligation under the lease)."

Mr. Fahy for the lessors argues that the Arbitrator is required to value the rent in the supposed situation of the entire property being vacant and available for occupancy in a number of convenient units collectively comprising the entire with the consequent benefit of the income therefrom to the lessee who may not necessarily be an occupier. This he calls "the market potential" of the property which involves, he submits, an objective assessment based on open market factors and not on any subjective factors affecting the personal circumstances of the lessee or the lessor. Mr. Fahy submits that the method of assessment of rent prescribed in the lease requires the Arbitrator to assume a hypothetical situation of vacant possession of the entire giving persons other than, as well as, the lessee an opportunity, as it were, to bid as in an open market situation for the entire premises as if vacant for occupation in its entirety with the benefit of income from potential sublettings to the best advantage as the lessee might determine. Mr. Farrell for the lessee contends that the Arbitrator must arrive at his determination of the rent by assuming the lessors were to offer the entire property on the market as a single letting with the income it yields from the

subletting of those portions not in fact vacant and the availability for occupancy or subletting of the portions not sublet at the time. The provisions of Clause D 3 (ii) (2), he argues, specify matters to which the Arbitrator must have regard and other matters he should disregard and so get an assessment of the rental value of the demised premises as it is found to be at the time the rent falls to be reviewed.

In opening the Case Stated on behalf of the lessors Miss. Glynn referred to the following authorities intended to be relied upon for the guidance of the Court upon the arguments being presented:

Volume 27 of the 4th Edition of Halsbury. Landlord and Tenant, page 166, paragraph 220:

United Scientific Holdings Ltd. .v. Burnley Borough Council 1976 Ch. D128;

Ponsford .v. H.M.S. Aerosols Ltd. 1979 A.C. 63;

Lear & Anor. .v. Blizzard 1983 3 All E.R. 662; and

F.R. Evans (Leeds) Ltd. .v. English Electric Company (1978) 36 P.C. Rep.35.

Reference was made during the course of argument also to Brett .v. Brett Essex Golf Club Ltd. And Anor. 1986 1 EGLR 154;

British Gas Corporation .v. Universities Superannuation Scheme Ltd. 1986 1 All E.R. 978.

In considering the authorities cited in argument I think it may be assumed that the parties to agreements prepared by or with the assistance of legal advisers wish to take guidance from known judicial interpretations. To avoid misunderstandings, they will, I expect, make use of expressions which have a meaning upon which both parties can be agreed having regard to the previous Court decisions. The lease for consideration now has been drawn with care and the choice of wording and mode of expression was made and adopted no doubt with the benefit of consideration of known Court decisions. The advice sought by the Arbitrator therefore is solely on the true construction of the terms of the lease. No assistance can be obtained from statutory provisions for renewal of expiring leases because this lease is a continuing one and the relationship of lessor and lessee remains uninterrupted for the 99 year term granted.

The authorities cited in argument relate to forms of rent review clauses in which there are material differences in the terms under consideration. However, the principle uniformly adopted is that the lease should be construed in the light of the circumstances of the parties to it as they existed at the time of the granting of the lease and in the light of the circumstances which the parties intended, as expressed and demonstrated in the provisions of the lease, and in the directions for the Arbitrator contained in the lease.

In British Gas Corporation .v. Universities Superannuation Scheme Ltd. 1986 1 WLR 398, a recent decision of the English Vice Chancellor, the rent review clause provided that the yearly rent payable from the rent review date

> "shall be the higher of (i) the Yearly Rent payable immediately before such review date and (ii)

the rack rental value of the demised premises at the relevant review date".

The lease there being considered defined the expression "rack rental value" as follows:

"Rack rental value of the demised premises means such rent as may be agreed or determined as hereinafter provided to be the best yearly rent at which the demised premises could reasonably be expected to let in the open market by a willing landlord to a willing tenant for a term equal to the term hereby granted by means of a lease containing the same provisions (other than as to the yearly rent) as are herein contained on the following assumptions...".

The other expressed assumptions are not set out in the report as the judgment relates only to the questions whether the rent exclusion provision (i) requires the valuer to ignore all provisions relating to rent in the lease; or (ii) requires the valuer to ignore those provisions which relate to the quantification of rent, i.e., the rent payable immediately before the relevant review date and the provisions for future rent reviews; or (iii) requires the valuer to ignore the rent actually payable before the review date only, i.e., he must take into account the provisions for future reviews of the rent. Such questions have been avoided by the terminology used in this Case Stated but the following statement of principle in the judgment of the Vice Chancellor was cited as applicable in this case:

"There is really no dispute that the general purpose of a provision for rent review is to enable the landlord to obtain from time to time the market rental which the premises would command if let on the

same terms on the open market at the review dates. The purpose is to reflect the changes in the value of money and real increases in the value of the property during a long term. Such being the purpose, in the absence of special circumstances it would in my judgment be wayward to impute to the parties an intention that the landlord should get a rent which was additionally inflated by a factor which has no reference either to changes in the value of money or in the value of the property but is referable to a factor which has no existence as between the actual landlord and the actual tenant, i.e., the additional rent which could be obtained if there were no provisions for rent review. Of course, the lease may be expressed in words so clear that there is no room for giving effect to such underlying purpose. Again, there may be special surrounding circumstances which indicate that the parties did intend to reach such an unusual bargain. But in the absence of such clear words or surrounding circumstances, in my judgment the lease should be construed so as to give effect to the basic purpose of the rent review clause and not so as to confer on the landlord a windfall benefit which he could never obtain on the market if he were actually letting the premises at the review date, viz., a letting on terms which contain provisions for rent review at a rent appropriate to a letting which did not contain such a provision."

The House of Lord's decision in Ponsford And Others. .v. H.M.S. Aerosols Ltd. 1979 A.C. 63 was cited in argument upon the construction of the phrase in Clause D 3 (ii) of the lease herein:

> "The yearly rent which....might then reasonably be expected on a letting of the demised premises with vacant possession on an open market by a willing lessor to a willing tenant."

The substantial basis of the dispute in the House of Lords case derived from a term of licence to make alterations and improvements in the demised premises, the lease being one containing provisions for periodic reviews of rent. The licence provided that all the conditions of the lease were to apply to the premises "when and as altered and shall extend to all additions". The revised rent, it was agreed, should be "a reasonable rent for the demised premises". The Court was divided in its judgment. The opinion of Viscount Dilhorne expressing the majority opinion might be summarized in this short extract from his speech. At page 76 of the report he is quoted as saying:-

> "Rent review provisions are now commonly included in leases at the instance of lessors to give them some protection against inflation. If they were not included, landlords might only be disposed to let for a shorter term. Their object is to secure that in real terms the rent payable does not fall below that initially agreed on. It was not disputed in this case that that is their main object. In the present case and in many others provision is made for the assessment

to be made by an independent surveyor. What has he to do? Surely it is to assess what rent the demised premises would command if let on the terms of the lease and for the period the assessed rent is to cover at the time the assessment falls to be made. That rent may depend to some extent on local factors such as deterioration of the neighbourhood. In assessing it, the surveyor will be assessing the reasonable rent that others, not just the sitting tenant, would be prepared to pay for the use and occupation of the premises. He will not consider the tenant's position separately".

In dealing with the wording of the particular lease before him the learned Lord went on to say at page 77:-

"The rent payable by the lessees will of course be rent for the demised premises but as I see it, the task of the surveyor is not to assess what would be a reasonable rent for the lessees to pay but what is a reasonable rent for the premises. That, when assessed, is payable by the lessees."

Lord Fraser of Tullybelton in support of the majority is reported at page 84 as follows:-

"The lease is an elaborate document and the tenants presumably took legal advice before entering into it. They are a business concern, able to look after their own interest, and there is nothing to suggest that they were misled or taken advantage of in any way. It is must unlikely that either party had this problem in mind when the terms of the lease were agreed. If the parties intended that the general law was to be varied

by special provisions in favour of the tenants, the time to make such provisions would have been when the licence for improvements was granted by the landlords, but that was not done. The problem is therefore to be solved by reference to the lease alone: it contains no express provisions in favour of the tenants on this matter and in my opinion it cannot, without distortion, be construed as making such provisions by implication."

Lord Keith of Kinkel also of the majority is reported at page 86 as follows:

"In my opinion the words "a reasonable rent for the demised premises" simply mean "the rent at which the demised premises might reasonably be expected to let." Considering that the demised premises necessarily include the improvements, to arrive at a lower rent by reason that the tenants paid for the latter would in substance mean that a rent for part only of the demised premises was being assessed. The fact that the assessed rent leads to an unreasonable result as between the particular tenant and the particular landlord does not mean that it is not a reasonable rent for the premises. The unreasonable result is due to circumstances which were not in contemplation when the terms of the rent review clause were agreed, and which were therefore not expressly provided for. They might have been expressly provided for at the stage when the licence for the improvements came to be granted, but they were not."

Two short extracts from the opinions of the dissenting minority may be helpful. Lord Wilberforce, having explained that he considered the reasonable rent to be determined as by the standard of what the lessor and lessee might themselves consider reasonable is quoted as saying at page 74 of that report:-

> "If the meaning of "reasonable" is not such as to admit the considerations to which I have referred I must ask what is its meaning or what is the "reasonable rent" referred to in the clause. The answer given to this is that the rent is the market rent. Then, when the question is asked why, if this is so, the clause does not so state, the answer given is that the word reasonable is put in so as to exclude a freak rent which some extraordinary lessee might offer. I must say that I find this a very lame argument. A market rent, or a rack rent, is one thing: a reasonable rent is another. A reasonable market rent is a hybrid which I cannot understand, and the clause, understandably, does not use these words."

In his dissenting judgment Lord Salmon is quoted at page 80 of the report as saying:-

> "No doubt, in many cases, the reasonable rent will turn out to be the open market rent of the demised premises - but not always; certainly not, in my view, if the demised premises, as in the present case, have been extended and improved by the tenant at his own expense. It is well settled law that the extension and improvements enure for the benefit of the landlord -

but not twice over, unless this has been expressly agreed by the tenant, as, for example, when the rent review clause provides that the rent shall be reviewed to coincide with the open market rent at the date of the review. I imagine, however, that even in such a case, a tenant who proposed spending a substantial sum of money in making additions and improvements to the demised premises would, before carrying them out, if properly advised by his solicitors, normally insist upon the landlords entering into an agreement that any increase in the open market rental of the premises caused by these additions and improvements should be disregarded in future rent reviews."

I have carefully read the opinions delivered in the House of Lords in United Scientific Holdings Ltd. .v. Burnley Borough Council and Cheapside Land Development Company Ltd. .v. Messels Service Company cited in argument. They trace in an interesting and enlightening way the divisions between and ultimate fusion of law and equity as administered in the Courts, and explain when and why time will be treated as of the essence of a contract, and distinguish between an option for review and an agreement to review the reservation of rent in leases. But for the purposes of the Case Stated by Mr. Mulcahy I do not think it necessary to direct his attention to any of the opinions expressed in that noble and learned Court.

The use in the Case Stated of the expression "market rental value" suggests that the decision of Donaldson J. (as he then was) in F.R. Evans (Leeds) Ltd. .v. English Electric Company Limited 36 P.C. Rep.185 had been considered

by the Arbitrator or brought to his attention. In that case the parties to the lease there under consideration had included in it a reference to the "full yearly market rental" and in the lease defined that expression as follows:-

> "The full yearly market rental for the purpose of this lease shall mean the rent at which the demised premises are worth to be let with vacant possession on the open market as a whole between a willing lessor and a willing lessee for the remainder of the said term outstanding at the end of such third or twelfth year of the said term as the case may be upon the terms and conditions of this lease (excepting stipulations in this lease as to the amount of the rent but including like provisions as to rent revision from any later date herein specified) without any fine or premium being taken and their being disregarded:...."

The matters specified to be disregarded relate to tenants fixtures and trade fixtures or fittings or improvements or additions carried out not more than 21 years previously or the fact that the lessee had been in occupation of the demised premises and any goodwill. That was a special case stated by an Arbitrator who included in his findings of facts among other matters the following:

> "1. There is no other property on the market that provides the accommodation and facilities provided by the subject property.
>
> 2. If the subject property had been vacant and in hand on October the 1st 1976: (a) the landlords could have adapted the property for letting in parts and could thereafter have let it in parts, and (b) it is

possible but unlikely that the landlords could have let the property on a long lease to a single tenant who would thereafter (have adapted it) for subletting in parts and sublet it in parts."

The third finding relates to demolition work and delays which would follow from the finding at No.2 and the findings continue as follows:-

"4. Apart from the present tenants, it is very unlikely on the available evidence and on the state of the market that there would have been a potential tenant in the market for the subject premises on the terms of the lease offered.

5. In October 1976, if the present tenants had not been in occupation of the subject premises, they would not have made any bid for the lease being offered.

6. The present tenants in October 1976 could have split their operation into parts and could have moved each of those parts into similar alternative premises."

While the foregoing quotations indicate that there are many matters which might arise for consideration on an arbitration of this nature which have not specifically been raised on this Case Stated, they also demonstrate that this Court can be of assistance to the Arbitrator only insofar as it can afford guidance by construing the agreement as expressed in the lease between the lessor and lessee and so presenting to him for

application by him the directions, as the Court construes them, which are set out by the parties in the lease.

The first, and I think, the most obvious fact is that the lessee has, subject to compliance with the covenants and conditions of the lease, the right not only to use and occupy the entire of the property demised for the entire 99 year term of years but also to determine what limited part to reserve for its own use and occupation and in respect of the remainder to distribute the use and occupation for inferior interests with the benefit of the income therefrom. Secondly, at the commencement of the term of 99 years there exist six subleases of portions of the demised property all for 21 year terms which probably conferred statutory rights of renewal on the sublessees. Thirdly, these subleases had been granted by the lessee on dates and for terms of years commencing antecedent to the date of the lease; the duration of the terms of years granted by these subleases do not coincide with the periods for review of the rent reserved by the lease. At paragraph B in the lease the habendum declares that the demise is "subject as aforesaid" but there seems to be nothing mentioned earlier to which this phrase relates. It may have been included on the assumption that the granting of, and the authority to grant, the subleases in the Second Schedule would have been recited and the demised premises would have been subject to and with the benefit of such inferior interests. From these facts it seems to me to be a necessary inference that the subject property, in respect of which the terms of lease were agreed, consisted of a parcel of land with buildings in respect of which it was accepted by both parties that such land and buildings were beyond the capacity (and the

intention) of exclusive occupation and use in their entirety by the lessee. A further inference which I think follows from the circumstances demonstrable from the lease is that the lessee would be entitled to, and would be expected to, create subinterests in the portions not in the lessees's actual use and occupation for which the lessee would remain primarily accountable to the lessors but from which the lessee would derive an income. These matters appear to me to have been in the contemplation of the parties in giving to the Arbitrator the directions contained in Clause D 3 (ii) 2.

The circumstances requiring the Arbitrator to consider and follow these directions can arise only upon the initiation thereof by the lessor prior to the seventh anniversary and every subsequent seven year period and the dispute thereof by the lessee by exchange of notices. Whether the Arbitrator be called upon on the seventh anniversary or on the seventy seventh anniversary his function will be the same, the relationship of lessor with lessee will be the same, other than the amount of the rent the terms and conditions governing that relationship will be the same, and, subject to improvements and sublettings, the demised premises will remain the same. At the time of making his assessment the Arbitrator is directed to take account of factors as they are found to be at such time. Although the yearly rent to be determined must be a single amount for the entire property the proviso in Clause D 3 (ii) 2 makes a distinction between the part of the rent attributable to the portion of the demised property in the use and occupation of the lessee and "those parts of the demised premises lawfully sublet by the lessee". That distinction is also made by the direction to disregard the effect

on letting value of the trade or business carried on at the time in any part (or parts) of the demised premises "except in respect of the portion of the demised premises in the actual occupation of the lessee itself". The direction to consider what amount of rent might reasonably be expected "on a letting of the demised premises with vacant possession on an open market by a willing lessor to a willing tenant" necessarily requires the contemplation of a hypothetical situation for the purpose of assessing market values appropriate to the time of assessment relative to the property. The personal requirements of the lessor and tenant for the time being would have to submit to the competitive situation of the property market at the time. If either party required special personal considerations to be taken into account they could, under the lease, negotiate without recourse to the arbitration clause. But the aspect of hypothetical vacant possession does not relate to the assessment insofar as it concerns the parts lawfully sublet. In respect of these parts the direction indicates a calculation of return on investment balancing the credit of the income against the debit of the responsibility by reference to the terms of the sublease in each case.

My understanding of the directions for the Arbitrator in Clause D 3 (ii) 2 is that he must calculate a rent for the entire property the subject of the lease as it is found by him to be at whatever review period he undertakes that function. That calculation will be an amount appropriate to the length of the then unexpired residue of the term of years granted by the lease, but will have two distinct constituents which will be subject to appropriate variation at each periodic rent review. In respect

of whatever portion of the demised premises is for the time being "in the actual occupation of the lessee itself" the hypothetical vacant possession test must be applied. In respect of whatever portion of the demised premises is for the time being lawfully sublet the test of its investment value on a balance of the actual return of income against lessor's liability must be applied. The directions to the Arbitrator in the lease do not, in my opinion, authorize any calculation of what potential yield of income the lessee (or any hypothetical lessee) might be able to secure for the portion of the demised premises not the subject, at the time of the rent review, of lawful subletting. In my opinion the amount of the rent reserved by the lease should be calculated on the basis that there is but one lessee who should pay a rent which combines what might reasonably be expected for the portion of which the lessee has exclusive use and occupation with the amount appropriate to the reversionary interest in whatever portions are actually lawfully sublet.

In advising the Arbitrator as in the foregoing I have refrained from using the expression "market rental value" adopted by him in the first question in the special Case Stated lest this should be a term for which some recognized legal interpretation may have already been stated. The questions as submitted, insofar as they incorporate alternatives, cannot be answered with a simple affirmative or negative answer. Question 2(b) seems to me to be founded upon a misunderstanding of the directions in the lease. The provisions of the lease giving directions to the Arbitrator are an expression of agreement reached by the lessor and the lessee. I do not believe it was their intention that the lessor or the Arbitrator would have any function of determining

rental values of subleases. I do not believe it was their intention that the lessee by granting subleases at rents determined by factors perhaps not known to, nor contemplated by, the lessor could be able to bind the Arbitrator in his function in relation to the rent reserved by the lease. In my opinion the Arbitrator has no function of assessing rental values for subleases. In regard to his function he will consider the existence and amount of such rents reserved by sublettings as facts representing, by their return to the lessee, the nature of the lessee's interest in the particular portion of the demised premises of which the use and occupation is lawfully withheld by the subtenant.

In these circumstances I think it best to conclude this opinion for the Arbitrator without attempting to answer the questions submitted otherwise than with the general guidance in the foregoing.

Seán Gannon