Neutral Citation No: [2024] NICA 84 *Judgment: approved by the court for handing down (subject to editorial corrections)**	*Ref:* **McB12649** *ICOS No:* **24/49528** *Delivered:* **12/12/2024**

IN HIS MAJESTY'S COURT OF APPEAL IN NORTHERN IRELAND

ON APPEAL FROM THE LANDS TRIBUNAL FOR NORTHERN IRELAND

BUSINESS TENANCIES (NORTHERN IRELAND) ORDER 1996

BETWEEN:

HERBERT SMITH FREEHILLS LLP

Applicant/Respondent

and

FITZWILLIAM TRUSTEES NO 1 LTD, FITZWILLIAM TRUSTEES NO 2 LTD AS TRUSTEES OF THE TULLYHAPPY PROPERTY UNIT TRUST

Respondent/Appellant

Mr R Coghlin KC and Mr D Stevenson (instructed by Carson McDowell LLP, Solicitors) for the Applicant/Respondent
Mr Fetherstonhaugh KC and Mr R Shields (instructed by Curran & Co, Solicitors) for the Respondent/Appellant

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Before: Keegan LCJ, Horner LJ and McBride J

McBRIDE J (*delivering the judgment of the court*)

Introduction

[1] This is an appeal against the decision of the Lands Tribunal (President, Huddleston J and the Member, Mr Henry Spence, MRICS) dated 4 May 2023, which determined that, upon a true construction of leases and agreements for works, works carried out by the applicant/respondent to an office building known as Cylinder Buildings located at 3 Cromac Quay, The Gasworks, Belfast were permissive and not carried out "pursuant to an obligation" to the respondent/appellant.

[2] At the appellant's request the President of the Lands Tribunal formulated a case stated which is the subject of this appeal.

Representation

[3] Mr Fetherstonhaugh KC together with Mr Richard Shields of counsel instructed by Curran & Co, Solicitors represented the respondent/appellant. Mr Richard Coghlin KC together with Mr Douglas Stevenson of counsel, instructed by Carson McDowell LLP, Solicitors represented the applicant/respondent.

[4] We are grateful to all counsel for their carefully crafted skeleton and oral arguments which brought forensic focus to the key issues in dispute and were therefore of much assistance to the court.

Background

[5] The applicant/respondent is a law firm which occupies part of the building known as the Cylinder located at 3 Cromac Quay, The Gasworks, Belfast ("the premises"). The applicant/respondent will be referred to in this judgment as the tenant.

[6] The respondent/appellant is the landlord of the premises.

[7] The premises were demised to the tenant by three leases dated 16 December 2010, 21 August 2013 and 24 June 2014 ("the leases").

[8] The tenant entered into three agreements for works dated 16 December 2010, 21 August 2013 and 25 July 2014 ("the works agreements").

[9] Under the works agreements, the tenant was to carry out extensive fitting-out works to convert the demised premises from "shell and core" to a full grade A category A office specification ("the works") at the tenant's expense.

[10] The respondent/appellant was not one of the original parties to the leases and works agreements. Rather the respondent/appellant acquired the reversionary interest in the premises from the original landlord in September 2014. The respondent/appellant will be hereinafter referred to as the landlord.

[11] On 22 April 2021 the tenant applied to the Lands Tribunal for new tenancies of the premises pursuant to the Business Tenancies (Northern Ireland) Order 1996 ("the 1996 Order").

[12] Article 18 of the 1996 Order provides that the rent payable under a new tenancy is the rent at which the holding might reasonably be expected to be let in the open market by a willing lessor subject to the following disregard:

> "18(2) (c) Any effect on rent of any improvement …

(i) carried out by the tenant … other than in pursuance of an obligation to the immediate landlord." [Emphasis added]

[13] In its submissions to the Lands Tribunal in October 2021 the tenant submitted that the tenant's works were to be disregarded for rental valuation purposes and therefore the premises were to be valued on a "shell and core" basis.

[14] Originally, the landlord agreed that the tenant's works should be disregarded for rental valuation purposes and his surveyor, Mr Ritchie, provided a witness statement to the Lands Tribunal in which he stated:

> "There is no doubt that those upgraded works should be disregarded for the purposes of the assessment of rent."

[15] The landlord subsequently instructed a different valuation expert and thereafter resiled from the agreed position and asserted that the tenant's works should not be disregarded for rental valuation purposes thereby meaning the rent would be assessed not on a shell and core basis but a grade A category A fit-out basis.

[16] The Lands Tribunal convened a hearing on the following preliminary point:

> "… Whether for the purposes of assessing the rent payable under the new tenancy, the … property needs to be regarded as fitted-out to grade A category A or alternatively to a shell and core specification."

[17] The dispute between the parties is simply whether the tenant's works were carried out pursuant to an obligation to the landlord. The landlord submits that they were and therefore ought to be rentalised so that the rental valuation would be based on grade A category A fit-out. In contrast the tenant submits the works were permissive and therefore ought to be disregarded for rental valuation purposes and rent ought therefore to be assessed on a shell and core basis.

[18] At the Lands Tribunal hearing the landlord submitted there had been a "commercial deal" between the parties, pursuant to which the tenant agreed to pay for the works in return for various concessions provided for in the lease. The landlord did not lead any evidence in support of such a commercial deal before the Lands Tribunal.

[19] On 4 May 2023 the Lands Tribunal held that the works were permissive and not carried out pursuant to an obligation and were therefore to be disregarded for rental valuation purposes meaning the rent was to be assessed on a shell and core rather than a grade A category A standard.

[20] At the landlord's request the President of the Lands Tribunal formulated the case stated which is the subject of this appeal.

Case stated

[21] The case stated formulates three points of law, which in summary are -

(a) Did the tribunal correctly and lawfully construe the leases and agreements for works ("the construction issue")?

(b) Was the tribunal entitled to find on the evidence that the lease and the agreements for works amounted to a "very poor deal" for the tenant ("the evidential issue")?

(c) Did the tribunal err in seeking consistency between the contractual rent review provisions and the provisions of Article 18 of the 1996 Order [this issue is linked to issue (a) the construction issue]?

Issues before the court

[22] The landlord does not appeal or make the case that there was a "commercial deal." The landlord now relies solely upon the construction point and accepts the evidential issue is irrelevant to the question of interpretation. The second question posed by the Lands Tribunal is therefore no longer relevant. Insofar as it is necessary to deal with the evidential question the finding by the Lands Tribunal that there was no evidence a commercial deal had been entered into has not been challenged. If there was no evidence of a commercial deal then the Lands Tribunal would not have been entitled to find the deal was a "very poor deal." We find however that upon a careful reading of the judgment of the Lands Tribunal, the Lands Tribunal made this comment in the context of the evaluative exercise it was undertaking by validly testing whether there was in fact a "commercial deal."

[23] Accordingly, the only issue to be determined is whether for the purposes of Article 18 of the 1996 Order the tenant's works under the works agreements were carried out in pursuance of an obligation to the landlord.

[24] The parties agreed that the answer to this question depended upon the true construction of the leases and works agreements.

Principles of construction

[25] In *Arnold v Britton* [2015] AC 1619 the Supreme Court set out the correct approach to be adopted to the construction of contracts, including contracts in the commercial sphere. At paras 15 and 20 Lord Neuberger stated as follows:

> "15. When interpreting a written contract, the court is concerned to identify the intention of the parties by reference to 'what a reasonable person having all the background knowledge which would have been available to the parties would have understood them to be using the language in the contract to mean' … And it does so by focussing on the meaning of the relevant words, … in their documentary, factual and commercial context. That meaning has to be assessed in the light of (i) the natural and ordinary meaning of the clause, (ii) any other relevant provisions of the lease, (iii) the overall purpose of the clause and the lease, (iv) the facts and circumstances known or assumed by the parties at the time that the document was executed, and (v) commercial common sense, but (vi) disregarding subjective evidence of any party's intentions. …
>
> 20. … while commercial common sense is a very important factor to take into account when interpreting a contract, a court should be very slow to reject the natural meaning of a provision as correct simply because it appears to be a very imprudent term for one of the parties to have agreed, even ignoring the benefit of wisdom of hindsight. The purpose of interpretation is to identify what the parties have agreed, not what the court thinks that they should have agreed. Experience shows that it is by no means unknown for people to enter into arrangements which are ill-advised, even ignoring the benefit of wisdom of hindsight, and it is not the function of a court when interpreting an agreement to relieve a party from the consequences of his imprudence or poor advice. Accordingly, when interpreting a contract a court should avoid re-writing it in an attempt to assist an unwise party or to penalise an astute party."

[26] Mr Ritchie provided evidence on behalf of the landlord at the Lands Tribunal. He signed a witness statement in which he stated that the tenant's works should be disregarded for the purposes of assessment of rent. Originally the landlord accepted that the tenant's works were to be disregarded. Later, after instructing a new expert it resiled from this position. Mr Fetherstonhaugh submitted that the landlord was entitled to do so as it was not bound by the evidence of Mr Ritchie as this statement did not consist of expert evidence but rather was an assertion on a matter of law. As the construction of the written documents is a question of law Mr Ritchie's statement is irrelevant. We accept Mr Fetherstonhaugh's submission that the landlord was entitled to resile from its original view and was not bound by the view of its surveyor as the question of construction of written documents, is a matter of law and not

evidence. Accordingly, the Lands Tribunal was right to allow the landlord to resile from its original position and to argue that the tenant's works were not to be disregarded. Insofar as the evidence of Mr Ritchie speaks to the subjective intentions of the parties this must also be disregarded when construing the documents because *Arnold v Britton* makes clear the subjective intention of the parties is to be disregarded when construing a written contract.

[27] Article 18 of the 1996 Order provides that improvements carried out by a tenant at the tenant's expense to the demised premises are to be disregarded when assessing rent at lease renewal. This so called "disregard" applies unless the works are carried out pursuant to an obligation to the landlord. The provisions of article 18 of the 1996 Order are to all intents and purposes identical to the provisions which apply in England and Wales pursuant to section 34 of the Landlord and Tenant Act 1954.

[28] It is also very common for leases to contain similar "disregard" clauses within their rent review provisions. These clauses have been the subject of some judicial consideration in England and Wales.

[29] The leading case is *Historic Houses Hotels Ltd v Cadogan Estates* [1993] 2 EGLR 151. In *Historic Houses Hotels* the tenant carried out works at his own expense to the demised premises. The rent review clause in the lease was akin to the provisions of article 18 of 1996 Order/section 34 Landlord and Tenant Act 1954. It provided that the tenant's improvements would be disregarded for rental valuation purposes upon rent review unless they were carried out pursuant to an obligation to the landlord. The landlord and tenant had entered into a number of licences under which the tenant was to carry out various works to the premises. The licences contained six covenants by the tenant concerning the way in which the alterations were to be executed and the timing within which the works were to be completed. Clause (g) provided that upon completion of the tenant's works the provisions of the lease shall apply to the premises as if the premises in their altered state had been originally comprised in the lease. The landlord contended that the mandatory language of the six covenants and the provisions of clause (g) displaced the application of the tenant's "disregard" and therefore the tenant's works would be taken into account when assessing rent at rent review.

[30] Knox J noted that "under the lease alone the alterations plainly would fall to be disregarded for rent review purposes, pursuant to a common form of provision to that effect based loosely on section 34(1) and (2) of the Landlord and Tenant Act 1954."

[31] He then set out the economic justification for this "disregard" as follows:

> "The economic justification for such a disregard is not far to seek. It is not particularly fair that a tenant, who, at his own expense, voluntarily improves the demised premises, should thereafter have to pay rent not only on what the

> landlord contributed, the unimproved premises, but also on the improvements."

[32] Knox J rejected the landlord's argument that clauses contained within the licence permitting the works, which required the tenant's works to be executed by a particular date and in accordance with certain standards, created a positive obligation on the tenant to carry out the works. He endorsed the views expressed in *Godbold v Martin The Newsagents Ltd* [1983] 2 EGLR 128 that such clauses were subsidiary to the licence and therefore did not create positive obligations. Knox J observed that the landlord's proposed construction of the licences would lead to a windfall for the landlord as the tenant's works would be rentalised. If such a result had been intended "the parties would have been very likely to say so in terms." In the absence of such clear terms in the licences he found that the disregard was applicable.

[33] On appeal Dillon LJ endorsed the economic rationale underlying the disregard for tenant's improvements. At page 117 of *Historic Houses Hotels Ltd v Cadogan Estates* [1995] 1 EGLR 117 he stated:

> "Such a disregard of alterations or improvements to demised premises made by the lessee at the lessee's sole expense is a very common provision in present rent review clauses and, indeed, it is envisaged in the Landlord and Tenant Act 1954. The obvious reason is that if a lessee carries out alterations or improvements to the premises at his own expense, and the alteration or improvements will enure to the benefit of the landlord after the expiration of the lease, it would not be fair or reasonable that the rent should be increased on rent review so that, in the inelegant phrase used by Mr David Neuberger QC, the alterations or improvements can be rentalised for the rest of the lease. It is plainly unfair that the lessee, who has paid for the alterations or improvements, should be required from the next rent review date to pay additional rent attributable to them also."

[34] If a disregard normally regarded as fair and reasonable is to be inapplicable in relation to alterations authorised by licences or agreements then Dillon LJ held that he would expect clear language to be used and observed at page 118 as follows:

> "Regarding this as a commercial bargain between the parties I would expect something very much clearer if it was to be established that a disregard normally regarded as fair and reasonable is to be inapplicable in relation to particular alterations authorised by a range of successive licences … If such a matter is the subject of negotiation between the parties and is agreed, one would normally

> expect it to be provided by express agreement in clear terms in relation to the rent review clause to make it clear what had been agreed. I would not expect a matter so unexpected as overriding the disregard to be dealt with in such an oblique manner as this."

[35] Hoffman LJ endorsed Dillon LJ's views and noted that it is "prima facie unfair that a tenant's rent should be increased on account of improvements at his own expense" and stated that if a tenant is to be considered as having accepted an obligation to carry out such works then the "language of the relevant clause [must] make this very clear."

[36] An example of such clear language was found in *Daejan Properties Ltd v Holmes* [1996] EGCS 185. In *Daejan* the lease contained a clause prohibiting the tenant from carrying out any alterations. The rent review clause contained the common form "disregard" for tenant's improvements unless carried out pursuant to an obligation to the landlord. After the lease was entered into, the parties entered into an agreement whereby the landlord permitted the tenant to carry out alterations otherwise prohibited by the lease. The agreement was called a licence and contained the following provision:

> "The works shall be deemed to be carried out pursuant to an obligation to the lessor."

[37] Neuberger J, applying the principles set out in *Historic Houses Hotels* held that the words in the licence were "clear enough" to override the disregard. He added:

> "…that is not a result which is commercially attractive, nor is it a result to use the words of Dillon LJ which is fair. On the other hand if the words are sufficiently clear or, in the words of Hoffman J, 'the words show beyond doubt that this is what the parties intended, the court must give them that effect.'"

[38] *Ridley v Taylor* [1965] 1 WLR 611 and *Godbold v Martin The Newsagents Ltd* addressed the question of whether the use of mandatory language in agreements relating to the manner in which the tenant was to execute the works and when the tenant was to complete the works created an obligation upon the tenant to carry out the works.

[39] In *Ridley v Taylor* the landlord and tenant entered into a licence under which the landlord granted the tenant permission to convert the premises into five flats. The licence required the works to be carried out "in a proper and workmanlike manner … to the satisfaction of the estate surveyor … and in accordance with the said drawing." The landlord submitted that the mandatory language used in the licence placed the tenant under an obligation to the landlord to carry out the works and therefore the

"disregard" did not apply when assessing rent at the rent review. Harmon LJ disagreed and held that upon a true construction of the licence, no obligation was placed upon the tenant to convert the demised premises, and he could choose whether to convert it or not. Similarly, Russell LJ held at page 620 para H:-

> "For my part I have no doubt that the covenant to complete the conversion in clause 10 (II) to the satisfaction of the estate surveyor is not a covenant to carry it out, but a covenant that if it is carried out it will be done in a particular manner."

[40] In *Godbold v Martin* the court followed *Ridley*. In this case the lease contained the common form rent review clause containing the usual disregard for works carried out by the tenant at the tenant's expense unless done pursuant to an obligation to the landlord. The landlord had granted licences to the tenant permitting the tenant to carry out improvements to the premises. The question arose whether the works were permissive or carried out under an obligation. The court held that the language used in the agreement was the language of permission. The agreement was called a licence and the licence recited the clauses in the lease which prohibited the tenant carrying out works. It then recited that the tenant requested the landlord to grant a licence to enable the tenant to execute such works and the landlord agreed to grant such a licence upon the terms and subject to the conditions set out in the licence. The trial judge held that the clauses in the licence which referred to how the works were to be carried out, could not be construed as imposing a positive obligation upon the tenant to carry out the works, as such clauses were subsidiary to the main licence to do the works. He took the view that covenants of this nature "are not generally to be construed as imposing positive obligations."

Principles to be gleaned from the authorities

[41] We consider the following principles can be distilled from these authorities:

(i) The rationale for the "disregard" of tenant's improvements when calculating rent at rent review or upon lease renewal, is that it would be unfair for a tenant who has paid for improvements to the premises, to then be required to pay rent in respect of these improvements - *Historic Houses Hotels Ltd* per Dillon LJ at page 117.

(ii) In light of the rationale for the "disregard" the court will require the parties to provide "by express agreement in clear terms" that the disregard is to be disapplied or overridden – *Historic Houses Hotels Ltd* per Dillon LJ at page 118.

(iii) A fair and reasonable construction must be given to documents created between the parties dealing commercially with each other - *Historic Houses Hotels Ltd* per Dillon LJ at page 118.

(iv) Where the language used by the parties is clear and shows beyond doubt that they intended the disregard to be overridden, the court must then give effect to it even if the result is commercially unattractive or unfair as per Neuberger J in *Daejan Properties v Holmes* [1996] EGCS 185 at 186.

(v) Where a landlord has granted a tenant a licence or permission to carry out works, clauses in the licence which require the works to be executed by a particular date or which regulate the manner in which the works are to be carried out are not generally to be construed as imposing an obligation on the tenant to carry out the works. This is because such clauses are "subsidiary" or "parasitic" to the licence granting permission to execute the works – see *Godbold* and *Ridley*.

(vi) The application of these principles is fact specific and accordingly the court must construe the words used in the documents entered into between the parties (usually leases, licences, works agreements), to determine, in accordance with the principles set out in the jurisprudence, whether the parties agreed in clear terms that the tenant was under an obligation to carry out the works and the disregard provisions would therefore be inapplicable.

The relevant clauses in the lease and works agreements

[42] To determine whether the leases and or works agreements placed a positive obligation on the tenant to carry out the works, it is necessary to consider the provisions of the leases and works agreements. The terms of each lease and each works agreement are similar. For convenience, and in line with the approach adopted by both parties, the court will refer to the terms of the first lease dated 16 December 2010 and the first agreement for works dated 16 December 2010.

Provisions of the lease

[43] The first lease dated 16 December 2010 was entered into between Belfast City Council, Ormeau Gasworks Ltd and the tenant. The recital states:

> "The landlord and tenant have agreed that in consideration of the rent reserved …"

[44] After the recitals there is a definition section which is followed by clause 2 which provides that the premises are demised for a period of 10 years. Clause 4 sets out the tenant's covenants and of particular note are the prohibitions contained in clauses 4(9), (10), (11) and (12) which prohibit the tenant carrying out alterations, additions, repair, decoration and electrical works unless the tenant obtains the approval of the landlord.

[45] Clause 22 provides under the heading "Business Tenancies Order":

> "The landlord and the tenant agree that for the purposes of Article 18 of the Business Tenancies (Northern Ireland) Order 1996 the execution and completion of the landlord's work under the agreement shall not be deemed to be undertaken pursuant to an obligation to the landlord."

[46] Part 7 of Schedule 1 to the lease sets out a number of provisions dealing with the calculation of rent at rent review, which is to take place every five years. The Schedule provides that the calculation of rent for rent review will broadly speaking be calculated at open market rental value based on a number of assumptions. The most notable of these are set out at clause 2.1.3 and clause 2.1.6. Clause 2.1.3 provides:

> "That the devised premises are fitted-out to the standard of finish as described in the specification hereto attached …"

The specification is "shell and core."

Clause 2.1.6 provides that:

> "That no work has been carried out to the demised premises by the tenant, … which has diminished the rental value of the demised premises (save in pursuance of an obligation to the landlord (other than (a) the execution and completion of the landlord's works under the agreement) …)"

[47] The calculation of open market rental value is also subject to a number of disregards set out at clause 2. Of note is clause 2.2.7 which provides:

> "Any effect on rent attributable to any physical improvement to the property carried out … by or at the expense of the tenant … and not pursuant to an obligation to the landlord (other than an obligation to comply with any law save an obligation arising under clause 4(19))."

Relevant provisions of the works agreements

[48] The works agreement dated 16 December 2010 was entered into between the tenant and the original landlord. Under "Background" it states:

> "(a) The landlord and tenant have entered into a lease of the property dated ___.

(b) The tenant has agreed to undertake certain works at the property on behalf of the landlord and the landlord has agreed to reimburse the tenant with the costs of the works."

There then follows a definition section, which defines landlord's works and tenant's works. Clause 1.1.8 provides for consents to be provided in writing before the relevant act is taken or event occurs.

[49] Clause 2 is entitled "Landlord's works" but its provisions also refer to tenant's works. The most pertinent provisions of clause 2 are clause 2.2.1 and 2.6. Clause 2.2.1 provides:

> "The tenant shall use reasonable endeavours to procure that the contractor shall carry out and complete the landlord's works and the tenant's works within 9 months from the date hereof in a proper and workmanlike manner and in compliance with the approved documents, the tenant's works specification and other requisite consents, and shall give all notices required to the requisite consents provided that the tenant shall not be obliged to complete the landlord's works and the tenant's works within 9 months if it is prevented from doing so for any matter outside of its control."

[50] Clause 2.6 provides that the tenant may make material variations to the approved documents with the consent of the landlord.

[51] Clause 3 deals with "Practical completion and rectification period" and contains a number of sub-clauses which state "the tenant shall …"

[52] Clause 4 deals with termination of the agreement in the event the landlord becomes insolvent.

Landlord's Case

[53] The landlord submits that, for the purposes of Article 18 of the 1996 Order, the tenant's works under the works agreements were carried out in pursuance of an obligation to the landlord and accordingly their effect on rent is not to be disregarded upon determination of the rent pursuant to the 1996 Order.

[54] In support of this contention Mr Fetherstonhaugh on behalf of the landlord submitted that, having regard to the words used in both the lease and the works agreement and the context of the agreements the parties agreed that the tenant was under an obligation to the landlord to carry out the works and therefore the "disregard" did not apply to these works.

Do the provisions in the lease create an obligation upon the tenant to do the works?

[55] Mr Fetherstonhaugh submitted that clause 2.1.6 provided a disregard for tenant's works subject to the common exception "save in pursuance of an obligation to the landlord." He maintained that it then created a "carve out" from this exception in relation to "the execution and completion of the landlord's works under the agreement." He submitted the creation of this carve out from the exception "save in pursuance of an obligation to the landlord" demonstrated that the drafters of the lease understood and intended that the works carried out under the works agreement were works carried out pursuant to an obligation, otherwise there was no need to create the carve out to the exception. The drafters deliberately did not include the tenant's works in the carve out to the "obligation" exception as the parties agreed the tenant's works carried out under the works agreement were carried out pursuant to an obligation and accordingly were to be rentalised.

[56] Mr Fetherstonhaugh submitted that this interpretation was consistent with the terms of Clauses 2.2.7 and clause 22. Clause 2.2.7 provided that improvements carried out by the tenant would be disregarded for assessment of rent at rent review unless carried out pursuant to an obligation to the landlord other than an obligation to comply with statute. The clause did not except the tenant's works under the works agreements and he submitted this was consistent with the landlord's construction of clause 2.1.6 that the tenant's works were carried out under an obligation and were therefore to be rentalised. Similarly, clause 22 which dealt with the 1996 Order provided that the landlord's works under the works agreement "shall not be deemed to be undertaken pursuant to an obligation to the landlord." No such deeming provision was applied to the tenant's works. He submitted the fact that clauses 2.1.6 and 22 did not provide such a deeming provision for tenant's works clearly demonstrated that the parties had agreed that the tenant's works were carried out under an obligation and were not to be disregarded for the purposes of assessment of rent at rent review and upon lease renewal.

Tenant's submissions

[57] In reply, Mr Coghlin submitted such an interpretation was not consistent with the other provisions of the lease most notably clause 2.1.3. He argued that the construction contended for by the landlord would make the provisions of the lease in respect of calculation of rent at rent review unworkable. He further submitted that the language used in the lease did not show in clear terms that the parties intended the tenant's "disregard" should be disapplied.

Consideration

[58] We are satisfied that upon reading the lease there is no clear language within it indicating that the parties intended to disapply the tenant's disregard. We come to this conclusion for the following reasons.

[59] The clauses contained within the lease must be read fairly and as a whole. We consider that the interpretation contended for by the landlord would lead to internal inconsistencies in the lease. Part 7 of Schedule 1 of the lease provides that rent at rent review, in the absence of agreement, is assessed by an independent valuer on a number of assumptions. One such assumption set out at clause 2.1.3 is that "the demised premises are fitted-out to the standard of finish as described in the schedule." The specification described is a shell and core finish. Accordingly, upon rent review, open market rental value is assessed on the assumption the premises are finished to a shell and core standard. Mr Fetherstonhaugh does not argue with this. Paragraph 2.2.7 then provides that in assessing open market rental value for the purposes of rent review there shall be disregarded "any effect on rent attributable to any physical improvement to the property carried out after the date of the lease, by or at the expense of the tenant … and not pursuant to an obligation to the landlord …" If the landlord's interpretation of the lease is correct that the works carried out by the tenant under the agreement which brought them up to category A grade A fit-out, are not to be disregarded for rent review purposes, then the consequence of this interpretation is that the valuer cannot carry out the express requirement to value on the basis of a shell and core specification as per clause 2.1.3.

[60] We agree with Mr Coghlin that the parties could not have intended such an unworkable position. The only way to resolve this tension and make the valuation provisions workable is to treat the works done under the works agreement as carried out other than in pursuance to an obligation to the landlord so that they can be disregarded and the holding valued as if finished to shell and core, as described in the specification. Accordingly, we consider the parties to the lease must have regarded the tenant's works under the agreement to be carried out "other than in pursuance to an obligation to the landlord" and therefore disregarded under clause 2.2.7.

[61] Mr Fetherstonhaugh placed great reliance on the exception to the exception in clause 2.1.6 as demonstrating the parties provided in clear terms that the disregard was to be disapplied. We consider clause 2.1.6, as is the nature of most rent review clauses, to be a complex clause. It is only upon a very careful and somewhat strained reading of this clause that the landlord's construction can be ascertained. We are satisfied that if the parties had intended the surprising result intended for by the landlord, (namely that the tenant's works are rentalised and the landlord receives a windfall) very much clearer language would have been used. We consider the parties would have said in clear and unambiguous language that the tenant's works were carried out under an obligation, in the same way as the parties did in *Daejan.* In *Daejan* the parties stated in unambiguous language that the tenant's works "shall be deemed to be carried out in pursuance of an obligation to the lessor." No such language appears in this lease and in the absence of such clear language we consider clause 2.1.6 does not state in clear terms that the disregard is to be disapplied.

[62] Clause 2.1.6 is the central plank of the landlord's argument. If it is not afforded the interpretation contended for by the landlord then the failure to except tenant's

works from works carried out under an obligation in clause 2.2.7 is unnecessary because the parties had not otherwise agreed such works were to be carried out under an obligation

[63] As to clause 22 we consider that the failure to mention the tenant's works is open to more than one interpretation. The tenant's works may not have been identified because the drafters did not think, in light of the existing case law such as *Historic Houses Hotels Ltd,* that the tenant's works would be considered as carried out pursuant to an obligation because this is prima facie unfair. Further it may be the landlord's works were specifically disregarded because landlord's works are normally rentalised. Unusually in this case the landlord's works were being carried out and paid for by the tenant and this clause was a "belt and braces" provision to ensure that what normally happens, (ie landlord's works rentalised) did not happen in this case.

[64] Accordingly, we find that clause 2.1.6, clause 2.2.7 and clause 22 do not bear the meaning contended for by the landlord. We consider that the tenant's construction is consistent with the other provisions in the lease. Further, even if the clauses in the lease can bear the construction contended for by the landlord, we consider that these clauses do not contain clear and unambiguous language that the disregard is to be disapplied as they are all open to more than one interpretation. Therefore, the landlord has not surmounted the high hurdle required to disapply the "disregard" and we conclude that the lease does not express in clear terms that the tenant's works under the works agreement were carried out under an obligation.

Do the provisions in the works agreement create an obligation upon the tenant to do the works?

[65] Mr Fetherstonhaugh submitted the provisions of the works agreement clearly provided that the tenant's works were carried out under an obligation. In support of this contention he relied upon the enforceability of the agreement, the context of the works agreement and the language used in the works agreement.

Is the works agreement an enforceable contract?

[66] Mr Fetherstonhaugh referenced that the Recital, after referring to the lease stated that the tenant had agreed to do certain works on the premises and the landlord would reimburse the tenant for the landlord's works. He submitted that this showed the tenant was entitled to occupy the premises in return for carrying out the works under the works agreement. Accordingly, there was an enforceable contract entered into and the works agreement was not therefore in its character a mere licence or permission to do the works. He submitted that it was not open to the tenant to argue there was consideration for the landlord's works which obliged the tenant to carry

them out but there was no consideration for the tenant's works and therefore they were not obliged to carry out the tenant's works.

[67] In response Mr Coghlin replied that the consideration for the lease was the rent and on the terms and conditions contained therein and therefore there was no bargain that the works were to be carried out in return for the tenant obtaining a lease. Further although there was consideration for the landlord's works within the works agreement, namely that the landlord would reimburse the tenant for the works, no such consideration applied to the tenant's works and therefore the landlord could not force the tenant to do the tenant's works.

[68] We accept that the consideration for the lease was the rent and the terms and conditions of the lease. There is nothing in the lease from which it can be inferred that there was an obligation on the tenant to carry out the tenant or landlord works in return for the grant of the lease. We do not however accept that there was no consideration for the works agreement. Mr Coghlin accepted there was consideration for the landlord's works as the landlord agreed to reimburse the tenant. However, he submitted that there was no consideration for the tenant's works in the works agreements. We do not accept this submission and agree with Mr Fetherstonhaugh that the works agreement is an indivisible whole and there is no basis for severing any of the clauses from it. This conclusion does not however determine the answer to the question whether the tenant's works were permissive or carried out pursuant to an obligation and it is therefore necessary to consider the context and provisions of the works agreement.

Does the context demonstrate the works agreement created an obligation on the tenant to carry out the works?

[69] The landlord submitted that, as the works agreement came into existence at exactly the same time as the lease, the works agreement did not permit that which was prohibited because the prohibitions contained within the lease (regarding the tenant carrying out alterations and improvements to the premises) only came into existence at the same time as the obligations created under the works agreement and therefore the lease clauses had no role to play in interpreting the clauses in the works agreement.

[70] In contrast the tenant submitted that the context supported the view that the works agreement constituted a licence permitting the tenant to do works which were otherwise prohibited under the lease at clauses 4(9), (10) and (12).

[71] We do not consider that the context assists in the construction of the works agreement as the context is open to competing constructions. On one construction, because the leases and works agreements were entered into on the same day, the prohibitions of the lease did not apply and therefore the works agreement cannot be construed as a licence to permit something which had not been prohibited. Alternatively, because the works agreement recites the lease it can be argued that the drafters of the works agreement were alive to the prohibitions contained within the

lease and the works agreement was the permission which authorised the tenant to carry out the works otherwise prohibited under the lease.

[72] Given the different interpretations applicable to the context we consider the context is of no assistance and it is therefore necessary to consider the provisions of the works agreement.

Does the language of the works agreement demonstrate an obligation?

[73] Mr Fetherstonhaugh submitted there was no permissive language in the works agreements. They were not called licences and unlike the permissions granted by the landlords to the tenants in the cases of *Ridley, Godbold* etc the works agreement did not contain a recital referring to the provisions of the lease which prohibited the tenant carrying out works and the works agreements did not state that the landlord consented to the tenant carrying out certain works which were otherwise prohibited under the lease. Additionally, any references to landlord's consent in the works agreement, for example at clauses 1.18 and 2.6, related to future approvals required and therefore did not demonstrate the tenant's works were done under a licence.

[74] In *Historic Houses Hotels Ltd, Ridley* and *Godbold* the leases all contained prohibitions preventing the tenant carrying out works to premises without the consent of the landlord. In each case the agreements entered into between the landlord and the tenant regarding the tenant's works were called licences and specifically recited the prohibition clauses in the lease and then stated the landlord consented to the tenant carrying out the works set out in the licence.

[75] In this case the works agreements are not called licences and do not contain a statement that the landlord is consenting to works otherwise prohibited under the lease. If such words had been used there would have been no dispute in this case that they were licences. As an aside this demonstrates the importance of clear drafting.

[76] The failure to use clear language outlining that the works agreement constituted a licence however does not conversely mean that the tenant's works were carried out under an obligation. As *Historic Houses Hotels* states, if the tenant's disregard is to be disapplied so that the tenant's works are to be rentalised, there is a need for "express agreement in clear terms" in the agreement entered into between the parties. It is therefore now necessary to consider whether there is any obligatory language in the works agreement.

[77] Mr Fetherstonhaugh submitted that the works agreement contained the language of obligation. This, he submitted, was most plainly seen in clause 2.2.1 which provided that the tenant was not excused from performance of the works save in remote circumstances, for example where the works could not be performed within a certain time or when the landlord became insolvent (as per clause 4.7). He submitted such a clause was enforceable by specific performance. He further submitted that all the sub-clauses in clause 3 used the mandatory language "the tenant shall …" He

contended that these sub-clauses could not be considered parasitic upon a licence, as was the case in *Ridley and Godbold,* because the works agreement was not a licence to do the works but rather placed an obligation on the tenant to execute the works.

[78] Mr Coghlin submitted that clause 2.2.1 did not impose an obligation upon the tenant to do the works but rather provided the period during which the tenant was entitled to carry out the works. He submitted that this clause was not materially different from the clause in *Historic Houses Hotels Ltd* which required completion "as soon as practicable", and this was held not to create an obligation to do the works. In the alternative he submitted that, even if clause 2.2.1 was to be interpreted as the landlord contended, the fact that there were possible competing constructions showed that the language used was not sufficiently clear to displace the disregard. As appeared from the jurisprudence there was a presumption the disregard applied, and there was an anxiety not to construe clauses as creating an obligation in the absence of clear language, due to the underpinning rationale for the disregard. He further submitted any language of obligation in the works agreement in clause 3 related to how and when the works were to be done, and these subclauses were therefore parasitic on the licence to do the works.

[79] We are not satisfied the works agreement expressly provide that the works were carried out under an obligation such that the tenant's disregard is to be disapplied.

[80] The jurisprudence demonstrates an anxiety not to construe clauses as creating an obligation in the absence of clear language due to the economic underpinning rationale for the disregard. The burden of proof is on the landlord to show that there is clear language in the agreement placing an obligation on the tenant to carry out the works. We consider that clause 2.2.1, as shown by counsels' competing constructions, is open to at least two different interpretations and is therefore ambiguous. Such language is therefore not clear enough to overcome the high hurdle required to displace the tenant's disregard.

[81] In the absence of any clauses in the works agreement which definitively show the parties agreed the works were carried out under an obligation, we consider that it is of no assistance to the landlord to seek to argue the mandatory language used in clause 3 creates such an obligation. In *Ridley, Godbold* and *Historic Houses Hotels* the mandatory language used in clauses relating to how and when works were to be carried out were held to not create obligations as they were considered to be subsidiary or parasitic on the licence. Clause 3 in the works agreement is framed in similar terms to the clauses in *Ridley, Godbold* and *Historic Houses Hotels,* as these subclauses relate to how and when the works are to be done. Such clauses have the potential to be considered as parasitic or subsidiary to a licence. Therefore, such clauses alone cannot definitively establish the existence of an obligation. In the absence of the landlord establishing the tenant's works were obligatory by reference to some other provisions of the works agreement, we consider the mandatory

language used in clause 3 cannot be relied upon alone as creating an obligation on the tenant to carry out works.

Does commercial common sense show the tenant was under an obligation to do the works?

[82] The tenant submitted the leases and works agreements had to be considered together and the landlord's interpretation of them made no business sense as the effect of the landlord's interpretation was that at lease renewal the tenant's works were rentalised but at subsequent rent reviews (given that the existing terms of the lease are usually carried over into the new lease) the rent would be assessed on a shell and core basis meaning the rental value would go down rather than up. Such a "yo yo" effect on rent cannot have been intended as normally rent increased at rent review. Therefore a reasonable man would construe the works agreement as meaning the tenant's works are not carried out under an obligation to the landlord.

[83] We consider in accordance with the guidance of Lord Neuberger set out in *Arnold v Britton* at para 15 we must assess the meaning to be attributed to the words set out in the works agreement in light of "commercial common sense." Mr Fetherstonhaugh accepts that his construction of the lease and works agreement could lead to a situation where, if the rent review clause of the lease is incorporated into the new lease, the rent assessed at rent review following lease renewal could be less than the rent fixed at lease renewal. He submitted, however, that it is not controversial for rent review to proceed on a different basis to statutory basis and the fact there is a "yo yo" effect on rent is no reason to construe them differently. He further argued that there was no certainty the rent review provision of the old lease would be incorporated in the new lease at lease renewal in which case there was no inconsistency and even if it was incorporated he submitted a hypothetical tenant bidding in the renewal market would take into account the prospect of lower rent in five years' time at rent review stage.

[84] In light of the presumption that the existing terms of the lease are carried over into the new lease (see *Gold v Brighton Corp* [1956] 3 ALL ER 442 and *O'May v City of London Property Co Ltd* [1982] 1 ALL ER 660) it follows that the rent review provisions of the lease will remain. In these circumstances we consider the parties cannot have intended that different considerations would apply to the calculation of rent at lease renewal and rent review such that at rent reviews following lease renewal the rent is likely to be less than that at lease renewal. We consider such a "yo yo" effect on rent is out of kilter with commercial practice where rent only increases at rent review. If the parties had wanted to achieve such a surprising result we would have expected them to say so in very clear, rather than oblique terms. We do not see any such clear language in either the lease or the works agreement.

[85] The inconsistency which the landlord's construction would create for assessment of rent at rent review and lease renewal, fortifies our conclusion that

neither the lease nor the works agreement are to be construed as creating an obligation on the tenant to carry out the works.

Conclusion

[86] We therefore find that the Lands Tribunal's conclusion that for the purposes of Article 18 of the 1996 Order the tenant's works under the works agreement were permissive and not carried out in pursuance of an obligation on the landlord and accordingly were to be disregarded upon determination of the rent pursuant to the 1996 Order was correct.

[87] In relation to the case stated we answer the questions raised as follows:

- Question 1 – yes.
- Question 2 – not relevant.
- Question 3 – no.

[88] Accordingly, we dismiss the appeal.

Costs

[89] The parties are encouraged to agree a costs position in default of which we will allow brief written submissions within two weeks of this judgment and will issue an order subsequently.