EXTRA DIVISION, INNER HOUSE, COURT OF SESSION

[2020] CSIH 2
CA40/18

Lord Menzies
Lord Drummond Young
Lord Glennie

OPINION OF THE COURT

delivered by LORD DRUMMOND YOUNG

in the cause

by

ASHTEAD PLANT HIRE COMPANY LIMITED

Pursuer and respondent

against

GRANTON CENTRAL DEVELOPMENTS LIMITED

Defender and reclaimer

Act: MacColl QC; Anderson Strathern LLP
Alt: D M Thomson, QC; Turcan Connell

21 January 2020

[1] The defender is the proprietor of a commercial property at 50 West Harbour Road, Granton. The subjects are let to the pursuer, the defender being the landlord under the lease. A rent review is currently under negotiation between the parties' agents. The review is based on the open market rent of the subjects as at 28 May 2017, but the parties are unable to agree on the manner in which rent is to be calculated, having regard to specific provisions in the parties' lease agreement. In short, the pursuer claims that the calculation of open

market rent should disregard all of the buildings and other constructions erected on and improvements carried out to the leased subjects. The defender, by contrast, contends that buildings and other constructions and improvements should only be disregarded to the extent that the relevant works have been carried out at the expense of the pursuer or its predecessors as tenant. To the extent that such buildings, constructions and improvements have been carried out at the expense of the defender or its predecessors as landlord, the defender contends that they should be taken into account in calculating the open market rent.

[2] The parties' lease is contained in a number of documents extending over the period from February 1988 to March 1997. The original lease document is a Minute of Lease between the Forth Ports Authority and EBH Services dated 2 and 25 February 1988 and recorded in the General Register of Sasines for Midlothian on 6 April 1988. The original term of the lease was from Candlemas (2 February) 1988 to Whitsunday (15 May) 2012. The Minute of Lease of 1988 has been varied by Minutes of Agreement between the landlords and tenants for the time being concluded in 1988, 1990 and 1994 and a Minute of Variation of Lease concluded in 1997. For present purposes the most important of these is the second, a Minute of Agreement concluded on 21 December 1989 and 20 April 1990.

[3] The leased subjects are described in clause FIRST (a) of the original Minute of Lease in the following terms:

> "ALL and WHOLE that land extending to one acre and thirty-four decimal or one hundredth parts of an acre or thereby with buildings and structures thereon at West Harbour Road, Granton, Edinburgh (hereinafter called 'the leased subjects') all as delineated and outlined in red on the plan annexed and executed as relative hereto".

Clause THIRD stated the original rent of the subjects, £7,370 per annum, and made provision for rent reviews on 15 May in every third year. The rent as so reviewed was to be

the greater of the existing annual rent and the "Open Market Rent" at the review date; that expression was defined in terms discussed below. Clause TWELFTH of the original Minute of Lease provided that the tenants should not be entitled to carry out any alterations or additions or erect new buildings on the leased subjects without first obtaining the written consent of the Forth Ports Authority. Clause TWENTY-FIRST (a) provided that on the termination of the lease the tenants should vacate the leased subjects and, if required by the Authority to do so, should be bound to remove all buildings or erections placed thereon by the tenants and to make good all damage caused to the property by such removal. The term of the lease was originally slightly more than 24 years, from Candlemas 1988 to Whitsunday 2012, but the last Minute of Variation of lease, concluded between Forth Ports PLC as landlords and the present pursuer and an associated company as tenant on 7 and 14 March 1997, extended the term of the lease to 28 May 2096. At the same time the rent was increased to £13,400 per annum, and rent reviews were to take place on 28 May 2002 and at five-yearly intervals thereafter. Following a rent review, the rent payable was to be the greater of that imposed in the year immediately before the review date in question and such sum as should represent the Open Market Rent, as defined in clause THIRD of the lease.

[4] The expression "Open Market Rent" is fundamental to the present dispute. It is defined in clause THIRD (c)(ii) of the original Minute of Lease, but that provision was amended by the Minute of Agreement concluded on 21 December 1989 and 20 April 1990 between the landlord and tenant at that time, those being the Forth Ports Authority as landlord and EBH Services and their assignee, PSP Ltd as tenant. So far as material clause THIRD (c)(ii) in its amended form was in the following terms; the amendment introduced in 1990 is underlined:

> "'Open Market Rent' shall mean the best yearly rent for which the leased subjects if vacant might be expected to be let, without fine or premium, as one entity by a willing landlord to a willing tenant on the open market at and from the review date in question for a period, running from the review date in question, equal in length to the original duration of this lease on terms similar in all respects to those contained or referred to in this Lease (save as to the amount of rent…) and on the assumption (if not a fact) that the Tenants have complied in all respects with all the obligations imposed on them under this Lease and, in the event of the leased subjects or any part thereof having been destroyed or damaged and not having been fully restored at the review date in question, on the further assumption that the destruction or damage had not occurred, there being disregarded however (1) any goodwill attached to the leased subjects by reason of the carrying on thereat of the business of the Tenants, (2) any work carried out in or to the leased subjects which has diminished the rental value of the same and (3) the effect on rent of all improvements carried out, with the prior approval of the Authority [the landlord], by the Tenants at their own cost after the date of entry hereunder provided such improvements are not in pursuance of an obligation to the Authority on the part of the Tenants, (4) the effect on any rent of the value of any buildings or other constructions erected on and any improvements carried out to the subjects of lease".

[5] The subjects of let extend to approximately 1.34 acres, in a location adjacent to Granton Harbour. The pursuer uses them for the purposes of its business, which consists of the storage, hire and sale of heavy plant and machinery for use in the construction industry. It was a matter of agreement that the subjects contain some buildings which existed at the time when the original lease was granted in 1988. Since that date no tenant has replaced those buildings or built any new structures. It was a matter of agreement before the commercial judge that offices and other buildings on the premises occupy approximately 20% of the gross area of the subjects of let. The remainder of the premises is used for the storage of plant and machinery.

The parties' dispute and the Lord Ordinary's decision

[6] Under the provisions of the Minute of Lease as amended, a rent review falls to be carried out as at 28 May 2017. It became clear in discussions between the parties' representatives that there was a fundamental disagreement as to the basis on which the

review should be carried out, and in particular as to the scope of disregard (4) added by the Minute of Agreement concluded in 1990. The pursuer, the current tenant, accordingly raised an action against the defender, the current landlord, for declarator that

> "the 'open Market Rent' (as that term is defined in clause THIRD (c)(ii) of the Lease) is to be calculated, *inter alia*, on the basis that disregard (4) within clause THIRD (c)(ii) of the Lease directs that the calculation is to disregard the buildings or other constructions erected on and improvements carried out to the Leased Subjects".

The result of that construction would be that all buildings, other constructions and improvements made to the subjects would be left out of account, even if those had been provided and paid for by the defenders or their predecessors in title as owners of the property and landlords under the lease. In advancing this contention the pursuer placed particular emphasis on the literal meaning of disregard (4), which refers to the value of "any" buildings or other constructions or improvements carried out to the subjects of lease. It does not refer to improvements undertaken or buildings constructed by the tenant, but is quite general in its application to buildings of every sort, regardless of who constructed them.

[7] The defender disputes that construction. It contends that disregard (4) does not direct the valuer to disregard the presence of any buildings on the subjects; the Lease is not a ground lease, and the valuation exercise should not be conducted as if it were a ground lease. The proper construction of clause THIRD (c)(ii), it is said, is that in the calculation of the Open Market Rent only improvements undertaken or buildings constructed by the tenant, or by the landlord after the date of entry, should be disregarded. The buildings that already existed at the date of entry should be taken into account in the valuation. Consequently the buildings on the Leased Subjects, which were all constructed by the

defender's predecessors as proprietors prior to the date of the original Minute of Lease, should be taken into account in the valuation.

[8] The Lord Ordinary observed that it was a matter of broad agreement that there was little, if any, relevant background against which the lease and the rent review provision fell to be construed. The buildings on the premises had been extant when the original lease was granted, and there was no suggestion that any tenant had replaced these or built new structures. The Lord Ordinary noted the general principles of contractual interpretation, and she considered a number of English cases that had been cited dealing with rent review provisions. She then held that the ordinary and natural meaning of the words of disregard (4) were to direct the surveyor to disregard the buildings or other constructions erected on and improvements carried out to the subjects of lease. A degree of tension existed between disregard (4), which read in isolation would exclude the buildings, and the definition of "Open Market Rent" found at the beginning of clause THIRD (c)(ii), which referred to "the best yearly rent for which the leased subjects if vacant might be expected to be let". That wording purported to include the whole of the leased subjects. Nevertheless, the Lord Ordinary thought that disregard (4) was consistent with the opening words of that clause, and could be explained by the fact that the disregard in question had been added by a later amendment.

Contractual construction

[9] The general principles of contractual construction are well established. The important principles are found in a number of recent cases, several of which were cited by the parties; these included *Rainy Sky SA* v *Kookmin Bank Co Ltd*, [2011] 1 WLR 2900, in particular at paragraphs 20-21, *Grove Investments Ltd* v *Cape Building Products Ltd*, 2014 Hous

LR 35, at paragraphs 10 et seq, *Arnold* v *Britton*, [2015] AC 1619, at paragraphs 15 and 76-77, *HOE International Ltd* v *Andersen*, 2017 SC 313, at paragraphs 18 et seq, and *Wood* v *Capita Insurance Services Ltd*, [2017] AC 1173. The correct approach may be summarized as follows.

[10] In the words of Lord Clarke in *Rainy Sky* at para [14]:

> "the ultimate aim of interpreting a provision in a contract, especially a commercial contract, is to determine what the parties meant by the language used, which involves ascertaining what a reasonable person would have understood the parties to have meant.… [T]he relevant reasonable person is one who has all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract".

Two important principles appear from this passage. First, a contract must invariably be construed contextually. This is an elementary point. Language is inherently ambiguous, and in no serious field of discussion is it possible to reach an intelligent view on the meaning of a particular passage without placing that passage in context. We will return subsequently to the importance of context in a case such as the present. Secondly, the exercise of construction is objective: the meaning of any particular provision is what a reasonable person in the position of the parties would have understood it to be. This principle is inevitable. A contract has two (or sometimes more) parties, and it is obvious that its meaning cannot be determined by the subjective intention or understanding of one of those parties. The court must take an objective view.

[11] Two further principles of construction are important. First, in interpreting a contractual provision the court should adopt a purposive approach. What this means is that in construing a contract the court should have regard to the fundamental objectives that reasonable persons in the parties' position would have had in mind. Essentially, the central provisions of a contract should, in any case of doubt, prevail over the subsidiary clauses.

The substance of the parties' agreement, construed objectively, should prevail over niceties of wording, and in particular over clauses that have not been well drafted.

[12] Secondly, in construing a contract a court may have regard to what is generally referred to as commercial (or business) common sense. Reference to commercial common sense has attracted a certain amount of criticism in recent years. Nevertheless, the authorities supporting its use are quite clear; they include most of the recent cases where the approach to contractual interpretation has been discussed. Contractual disputes frequently involve wording that is capable of having more than one meaning. This may involve conflict between the most literal meaning of a word or phrase and an alternative meaning that makes better commercial sense in context and according to the fundamental purposes of the contract. In relation to such cases, in *Rainy Sky* Lord Clarke stated at paras [20]-[21] (a passage expressly approved and followed by Lord Hodge in *Arnold* v *Britton* at para [76]):

> "[20] … It is not… necessary to conclude that, unless the most natural meaning of the word produces a result so extreme as to suggest that it was unintended, the court must give effect to that meaning.
>
> [21] The language used by the parties will often have more than one potential meaning. I would accept… that the exercise of construction is essentially one unitary exercise in which the court must consider the language used and ascertain what a reasonable person, that is a person who has all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract, would have understood the parties to have meant. In doing so, the court must have regard to all the relevant surrounding circumstances. If there are two possible constructions, the court is entitled to prefer the construction which is consistent with business common sense and to reject the other".

[13] In the same opinion Lord Clarke went on (at paras [29]-[30]) to adopt a statement by Longmore LJ in *Barclays Bank PLC* v *HHY Luxembourg SARL*, [2011] 1 BCLC 336, at paragraphs 25 and 26:

> "[W]hen alternative constructions are available one has to consider which is the more commercially sensible.… If a clause is capable of two meanings,… it is quite possible that neither meaning will flout common sense. In such circumstances, it is much more appropriate to adopt the more, rather than the less, commercial construction".

Furthermore, such an approach is not subject to additional qualifications, for example that a literal construction would produce an absurd result:

> "[I]f the language is capable of more than one construction, it is not necessary to conclude that a particular construction would produce an absurd or irrational result before having regard to the commercial purpose of the agreement.… 'But language is a very flexible instrument and, if it is capable of more than one construction, one chooses that which seems most likely to give effect to the commercial purpose of the agreement' (*Rainy Sky* at paragraph 43, quoting Hoffman LJ in *Co-operative Wholesale Society Ltd v National Westminster Bank PLC*, [1995] 1 EGLR 97)."

Thus in any case where a contractual provision is capable of bearing more than one meaning, the court should adopt the construction that best accords with commercial common sense. Use of the concept of commercial common sense has been specifically approved in other recent cases, including *Arnold* v *Britton*, *supra*, at paragraph 15, and *HOE International Ltd* v *Andersen*, *supra*, at paragraph 22.

[14] The concept has been the subject of criticism in commentaries on the case law, largely on the ground that it is too uncertain or nebulous to be of practical use. We are nevertheless of opinion that commercial common sense is an important aid to the construction of contracts, and indeed commercial dealings of every sort. Common sense at a general level is frequently used in practical reasoning. In general, it involves a double process: is a conclusion (a deduction or inference) one that is widely held by those with a knowledge of the particular field under consideration ("common")? And does the converse of the conclusion make sense? If it does not, it is likely that the conclusion is correct (or makes "sense"). The notion of common sense has been the subject of a considerable amount of philosophical commentary. For present purposes, it is sufficient to note the writings of

Thomas Reid, notably his Essays on the Intellectual Powers of Man, Essay 1, chapters 2, 7 and 8 (1785). Reid placed particular emphasis on the manner in which conclusions may be derived from the use of language, properly analyzed). "Commercial" common sense involves applying these concepts to business transactions or business relationships, but with the addition of elementary microeconomics; "microeconomics" is merely the branch of economics that covers the behaviour of individual firms (or individuals or families) in their commercial dealings with other persons. We would emphasize the word "elementary". The court should not embark on anything approaching a full professional economic analysis. What it must do is rather to consider how a reasonable person in business would be likely to conduct his or her affairs in a particular situation.

[15] That may involve consideration of the practice that is followed in a particular trade. For example, in *Jacobs* v *Scott & Co*, 1900, 2 F (HL) 70, evidence was led about the requirements of the Glasgow market for hay (the standard required was higher than that required elsewhere), and in *Charrington & Co Ltd* v *Wooder*, [1914] AC 71, evidence was led about the workings of the market for the supply of beer to public houses in London. In such cases evidence is obviously necessary in the absence of agreement by the parties. The basic manner in which a business conducts its affairs, however, is a matter that should lie comfortably within judicial knowledge.

[16] It is perhaps useful to mention three features of general business conduct that will frequently be relevant; all are of assistance in the present case. First, contracts are based on the principle of consideration, or exchange. This involves the notion of the *quid pro quo*; it is normal to find that the obligations of one party are broadly equivalent to the obligations of the other party. There may be exceptions, where a bad bargain has been concluded, but equivalence is the norm, and contracts should generally be construed accordingly.

Secondly, the principle *pacta sunt servanda* applies; parties expect to perform their contractual obligations. For this reason they will normally avoid the risk of unreasonable or disproportionate burdens. Thirdly, predictability is generally regarded as important. For that reason the parties to a contract will normally try to avoid obligations or burdens that operate in an arbitrary manner. Conversely, they do not expect windfalls. Nevertheless, commercial "predictability" is not achieved by construing contracts with brutal literalism, a practice that can easily produce arbitrary results; it is rather achieved by the use of a contextual and purposive construction of the words used, with the application where appropriate of commercial common sense. The foregoing three features, equivalence, avoidance of the risk of disproportionate burdens, and predictability, appear to us to be important aspects of commercial common sense, although we do not suggest that they are an exhaustive list.

[17] Finally, in relation to commercial common sense, we note that the concept is liable to overlap with both context and a purposive interpretation of a contract. The overlap with context applies in particular to the legal context, where the approach that has been taken by judges in decided cases may give important guidance as to what is commercially sensible in a particular situation. It also applies to the context that appears from the type of contract in question; the general type of contract can be regarded as a norm against which the particular features of the parties' contract can be judged, to assess how that contract might be expected to operate on a sensible commercial basis. So far as purposive interpretation is concerned, commercial common sense is frequently an invaluable guide to the fundamental purposes that a contract is intended to achieve.

Construction of clause THIRD of the parties' lease

[18] Clause THIRD is a rent review provision, providing for periodic review of the rent payable by the tenant. Such clauses are standard in long leases, and their commercial purpose is obvious: to ensure first, that the level of rent keeps pace with inflation, and secondly, that the rent payable reflects any changes in the subjects of let. In this way a rent review clause is an attempt to ensure that the consideration provided by each party remains broadly equivalent. Furthermore, because of the impossibility of foreseeing the future with certainty, the existence of a rent review clause reduces the risk that unreasonable or disproportionate burdens may arise; this will typically be the risk to the landlord that it fails to obtain, through the payment of rent, the true value of the subjects that it owns. A rent review clause typically includes provisions for valuation by an independent expert. This is intended to avoid the risk that future rent increases or decreases will operate in an arbitrary manner, unrelated to the underlying economic reality; the valuer is expected to ensure that the rent is kept in line with the market rents of comparable properties, and thus to preserve the fundamental principle of equivalence.

Context

[19] The Lord Ordinary observes that the parties agreed, at a general level, that there was little if any relevant background against which the lease and the rent review provision could be construed. It is correct that evidence was not available as to the specific matters that were thought relevant at the time when the lease was concluded and at the time when the lease was amended in 1990. Nevertheless, that does not mean that no context is available. We have already stressed that context is of fundamental importance in construing any text, contractual or otherwise. In construing a contract, the relevant context includes at least four

elements. The first of these is the particular dealings that the parties had at the time when they entered into the contract, or sometimes in their previous dealings with each other. That form of context depends on evidence. Nevertheless the dealings of the parties are only one aspect of context, and the absence of evidence about such dealings does not mean that the contract must be treated as in some way acontextual.

[20] The second form of context is found in the terms of the particular contract concluded between the parties, construed as a whole - what might be described as "internal" context. This runs into the purposive nature of the exercise of construction - it is through consideration of the whole of the contract that its essential purposes are determined. This may be important if, as often occurs, one of the lesser clauses is poorly drafted; in that event any ambiguity in the latter should be resolved in such a way that the fundamental purposes are fulfilled. The third aspect of context is the type of contract that is under consideration. The great majority of contracts fall into well-established categories such as sale, employment, agency or, as in the present case, lease. Contracts falling within such a category have common features. These include common objectives, and also standard types of clause to deal with particular problems that regularly arise in performing such contracts. Standard forms of contract may themselves provide an important context, in demonstrating the types of problem or dispute that frequently occur and how reasonable persons concluding such contracts will expect such disputes to be resolved. Textbooks dealing with a particular form of contract may contain valuable discussion of typical problems and disputes, and may give a good indication of the resolution that would be expected by reasonable parties to such contracts. This is, we think, of importance in the present case, where we were referred to works on rent review and the rent review sections of textbooks on leases.

[21] Fourthly, the legal context is relevant. Contracts are concluded against the background of the general law and are intended to operate having regard to that background. Furthermore, the general law provides default rules that will apply if a contract says nothing about a particular issue. Both the general law and its default rules indicate the manner in which, in past cases, judges have sought to strike a fair balance between the competing interests of contractual parties. The views of judges, typically developed through a series of cases, are likely to represent commercial common sense, and can serve as a benchmark against which considerations of fairness, reasonableness and practicality can be measured. If a particular construction of a contractual term differs radically from the corresponding common law rule or the default rule, that may raise a doubt as to whether that construction was truly intended by the parties, who are presumed to act in a commercially sensible manner. This may be less important in construing the substantive part of the main terms of a contract, because that will usually be the subject of both specific negotiation and legal advice; consequently any provision that does not appear commercially sensible may be the result of either trade-offs in negotiation or a bad bargain for one of the parties. In the case of subsidiary terms, however, or qualifications or limitations added to terms, the level of negotiation will usually be much less, and legal advice may be limited. In those cases the common law rules may provide assistance in deciding what commercially sensible parties are likely to have intended: compare *Grove Investments*, *supra*, at paras [12]-[13].

The terms of the lease as a whole

[22] On the facts of the present case, context is available from the terms of the lease itself. This is a commercial lease which will remain in existence, following the variation in 1997,

until 28 May 2096. In a lease of that length it is to be expected that provisions will be inserted to deal with the changes of circumstances that are inevitable over a long period, notably in the form of inflation and any changes in the subjects of let. The rent review clause is intended to deal with those possibilities, and it must in our opinion be given proper commercial effect. The lease is not a ground lease; the Lord Ordinary so held (para [32]), and in our opinion she was clearly correct in doing so. A ground lease is described in Rennie on Leases at paragraph 9-13; it is a lease in which the subjects let comprise a vacant plot of ground with an entitlement or obligation on the tenant to build. In the present case it was a matter of agreement that the main buildings and structures had all been constructed before the lease was originally granted; thus the subjects of let included substantial buildings at the time of the original lease. Furthermore, the definition of the "leased subjects" includes buildings and structures (see para [3] above). Consequently the rent is payable not merely for an area of land but for what had been constructed on that land. It follows that the rent, the consideration for the let, includes buildings and other structures as well as the land itself. This is important, because the landlord is providing both land and buildings and the consideration for doing so, the rent, should be generally equivalent in value to what the landlord has provided.

[23] Apart from the particular provisions of the parties' lease, the context includes the commercial lease as a specific type of contract: this takes in the objectives of such a contract and the provisions that are typically encountered in such contracts. We were referred to a number of cases decided in the English courts and by the Privy Council, and to textbooks on leases and rent review in both Scotland and England and Wales. These provide useful context to provisions governing rent review. The construction of rent review clauses is discussed at length in Reynolds and Fetherstonhaugh, Handbook of Rent Review, in

particular in chapter 2. The case law is discussed at paragraphs 2.4.2 and 2.4.3, with reference to substantial numbers of authorities. In the first of those paragraphs the general approach to rent review clauses is expressed in the following terms:

> "[W]hen there is any doubt on how to apply a rent review clause to particular facts one must seek the presumed intention of the parties, from the lease, taken as a whole and in context. In each case, it is suggested, the intention is that in return for the right to continue as tenant conferred upon him by the lease, the tenant is to pay and the landlord is to receive the rent obtainable if the premises were in hand, with vacant possession, in the state which the tenant ought to have put or kept them. The tenant gets his security, the landlord gets his market rent – that is the fundamental equilibrium between the parties. And it is in the context of that equilibrium that rent review provisions should be considered".

[24] In Rennie, Leases, at paragraph 27-02 it is stated that care should be taken in applying English statements of the law in view of the differences between the two systems. We agree with that general caution, but we consider that the purpose of a rent review provision is fundamentally similar in both jurisdictions, and is accurately stated by Reynolds and Fetherstonhaugh in the passage quoted. Rennie describes that purpose in the same paragraph, 27-02, where it is stated that

> "A well-drafted rent review clause allows the landlord to take account of fluctuations in market value so that the tenant is paying throughout the duration of the lease a rent which equates in real terms with the market rental value of the subjects".

That appears to us to be essentially similar to the statements found in Reynolds and Fetherstonhaugh. The objective of a rent review clause is to secure that the rent payable by the tenant remains in line with market conditions; that is what is meant by "the rent obtainable if the premises were in hand, with vacant possession, in the state which the tenant ought to have put or kept them". That in our opinion is the fundamental objective of rent review clauses. For present purposes, we would emphasize that both of the passages quoted refer to the "premises" or the "subjects"; the rent is obviously intended to relate to what has actually been let by the landlord to the tenant. The underlying principle in all

cases is equivalence of obligation, or "equilibrium", the word used by Reynolds and Fetherstonhaugh. This must be maintained despite changes in the value of money or the subjects of let: see para [18] above.

[25] The need to identify the premises properly is emphasized by Reynolds and Fetherstonhaugh at paragraph 4.4, where the logical starting point for valuation under a typical rent review clause is described as being "to ascertain the physical subject matter of the valuation". This, it is stated, will usually be "the premises" specified in the actual lease, but on occasion a departure from that may be dictated by the rent review clause. It is clear, however, that the norm is to use the actual premises, and that any departure from the norm must be clear from the wording of the rent review clause. Rennie, at paragraph 27-08, states that

> "As a first step, it is essential that there is clarity as to what it is that is being let under the hypothetical letting. This may seem obvious and, in most cases, it is. In such cases, one must only have regard to the leased subjects as described, along with all relevant pertinent rights…".

This point appears to us to be a matter of elementary commercial common sense.

[26] Rennie (chapter 27) and Reynolds and Fetherstonhaugh, and also McAllister, Scottish Law of Leases (chapter 12), make extensive reference to the factors that are relevant in rent reviews and in the drafting and construction of rent review clauses. We were also referred to three cases, *Ponsford* v *H M S Aerosols Ltd*, [1979] AC 63, per Viscount Dilhorne at 77D-F, *Goh Eng Wah* v *Yap Phooi Yin*, [1988] 2 EGLR 148, at 149H-K,, and *Ravenseft Properties Ltd* v *Park*, [1988] 2 EGLR 164, and 166B-D. By way of example, in *Ponsford* v *H M S Aerosols Ltd*, Viscount Dilhorne stated (at page 77 D-F):

> "[T]he 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.… If the effect on the rent of the improvements is to be disregarded then in my opinion an express provision is required to effect that…".

In *Goh Eng Wah* v *Yap Phooi Yin*, Lord Templeman, delivering the opinion of the Privy Council, stated

> "[I]f the parties intended that the rent fixed by an arbitrator should ignore the buildings on the land, they should and would have given express instructions to the arbitrator for that purpose. In the absence of any such express instructions in the lease,… the lease on its true construction does not authorize any deviation from the usual rule and it follows that the rent must be fixed by reference to the land and the buildings thereon".

All of those textbooks and cases emphasize the fundamental point that a rent review provision will normally take account of the actual premises that are let, including buildings on the land. Any departure from that requires express provision. That is in our opinion an important part of the context that governs the present rent review clause.

[27] The third form of context that is relevant to the present case is the legal context, including provisions that are commonly encountered in rent review clauses in commercial leases and the default rules that may apply if nothing is said. This has largely been covered in the last four paragraphs; there is typically an overlap between the purely legal context and the provisions that are commonly encountered in a particular type of transaction. Nevertheless, at a purely legal level, a rent review clause is essential if rents are to be kept in line with inflation. Furthermore, it is of the essence of bilateral contracts of every sort that there should be a broad equivalence in the consideration provided by each party. In the case of a rent review, that will not be achieved if a significant part of the let premises is left out of account in fixing a revised rent.

The terms of clause THIRD

[28] Clause THIRD (a) provides for an annual rent of £7,370 per annum "or such increased sum as may be substituted therefor as hereinafter specified". Clause

THIRD (c) provides for periodic review of the rent, in every third year from 1991 onwards. That provision has been replaced by clause 3 of the Minute of Variation of 1997 (see para [3] above), and rent review is now directed to take place in every fifth year from 28 May 2002 until the termination of the lease in 2096. Both the original clause THIRD and the revision effected by clause 3 of the Minute of Variation specified that rent review could only occur in an upward direction. Under clause THIRD (c)(i), the criterion for review is to be the "Open Market Rent (as after defined) at the review date in question". The reference to Open Market Rent is repeated in clause 3 of the Minute of Variation.

[29] "Open Market Rent" is defined in clause THIRD (c)(ii), whose terms are quoted above at para [4] in the form that is now current. The primary definition is

> "the best yearly rent for which the leased subjects if vacant might be expected to be let… as one entity by a willing landlord to a willing tenant on the open market at and from the review date in question"

for a period and subject to terms similar to those in the lease. This is in accordance with the passages from the textbooks by Reynolds and Fetherstonhaugh and Rennie that are quoted above at paras [22] and [23], where reference is made to market rental value. Two assumptions are then stated. First, it is assumed that the tenants have complied in all respects with their obligations under the lease. Secondly, if any part of the subjects has been destroyed or damaged and has not been fully restored by the review date, it is to be assumed that the destruction or damage had not occurred. The purpose of the first assumption is clearly to ensure that the amount payable by the tenants is not adversely affected by the tenants' failure to look after the subjects properly, as they are obliged to do by clause FIFTH of the lease. The purpose of the second is broadly similar, although it is expressed in neutral terms and would apply to destruction or damage that has been caused accidentally, or by the act of a third party. Underlying both of these assumptions is the

proposition that the rent is payable for the subjects let in the state in which they were originally let, with all the buildings constructed thereon. This reflects the fact that the lease is not a ground lease but is a lease of land and buildings.

[30] Clause THIRD (c)(ii) then specifies four matters that are to be disregarded in a rent review. The first of these is goodwill attached to the leased subjects by reason of the tenants' carrying on business. The purpose of this provision is to ensure that the goodwill of the tenants' business belongs to them, and does not result in an increase in rent (such as could occur if as sometimes occurs that goodwill attaches to the premises). The second disregard relates to any work carried out to the leased subjects which has diminished the rental value. This refers to secure the earlier provision that rent review is only to operate in an upward direction. The third disregard relates to all improvements carried out, with landlords' approval, by the tenants at their own cost, provided that they are not carried out pursuant to any obligation by the tenants to the landlords. The purpose of this provision, which is of a type commonly encountered in rent review clauses, is to ensure that if the tenants improve the premises they will not require to pay more rent for what they have done at their own expense. That clearly represents commercial common sense; the principle of equivalence, or equilibrium, requires that the tenants should pay for what the landlords have provided but not for anything that they have themselves provided.

[31] If the foregoing provisions had existed without any further disregard, the result would in our opinion have clearly been that the Open Market Rent was to include not only the land let by the landlords to the tenant but also the buildings constructed on that land by the landlords. That is apparent from the basic definition of the Open Market Rent, which refers to the best yearly rent for which "the leased subjects" might be expected to be let by a willing landlord to a willing tenant in the open market. The definition of the leased subjects

found in clause FIRST (a), quoted in para [3] above, expressly includes the "buildings and structures" on the area of land that is let. Even without that definition, a lease of the land would invariably include the buildings constructed thereon as a matter of elementary land law, in the absence of an express exclusion. The assumption that the tenants have complied with their obligations likewise points towards the proposition that rent is payable for the buildings, because the primary obligations to which this relates are obligations of maintenance and repair, found in clause FIFTH of the lease. The assumption that destruction or damage had not occurred also clearly assumes that the buildings are part of the subjects of let for which the rent is payable; if that were not so the exclusion would serve no useful purpose.

[32] Similarly, the second and third of the disregards would be of minimal effect if the buildings were not included in the subjects for which rent is payable, and which are therefore to be taken into account in the process of rent review. If the buildings were not included, any work that diminished their rental value and any improvements to them carried out by the tenants would be of no moment in a rent review. The effect of the second and third disregards would therefore be confined to matters such as the deterioration or resurfacing of the parking areas in the subjects. It would relate to the land only, and not the buildings.

[33] The fourth disregard, which was introduced in 1990, must be construed as part of clause THIRD taken as a whole and in accordance with the whole provisions of the lease. If that disregard is intended to exclude the value of all buildings and other constructions and all improvements, it contradicts both the basic definition of the leased subjects in clause FIRST, which expressly includes the buildings, and the earlier provisions of clause THIRD, which plainly assume that the buildings are to be taken into account in any rent review. In

our opinion this contradiction is clear on the terms of the lease. Furthermore, it is a contradiction between the basic definition of the leased subjects, one of the most fundamental aspects of any lease, and one particular detail relating to the manner in which rent reviews are to be carried out, which does not have the same fundamental character. In these circumstances we are of opinion that there is an important ambiguity as to the scope of the fourth disregard. If it relates to the whole of the buildings, including those constructed by the landlords before the date of entry under the lease, it is inconsistent with the remainder of the lease.

[34] In these circumstances it cannot be said that the fourth disregard, objectively construed in the context of the lease as a whole, is clear in its effect. It must accordingly be construed in accordance with the fundamental purpose of clause THIRD and, importantly, with commercial common sense. When that is done, the only sensible conclusion is in our opinion that the fourth disregard was intended, on an objective basis, to relate only to improvements undertaken or buildings constructed by the tenant at its cost, or by the landlord after the date of entry under the lease. Unless it is construed in that way, the rent review provision in the lease flouts commercial common sense. First, it would contravene the fundamental commercial principle that the obligations on one side should normally be broadly equivalent to the obligations on the other side. If the tenants obtain the benefit of the buildings constructed on the site by the landlords before the original date of entry without paying rent for them, that is quite contrary to the principle of equivalence. Secondly, if buildings provided by the landlords are disregarded, that would be on a commercial basis a disproportionate burden on the landlord, which would remain in existence until 2096, when the lease is now due to end. Thirdly, if the buildings are excluded

from the calculation of rent, that is a result that confers a windfall on the tenant of an essentially arbitrary nature.

[35] Furthermore, the authorities and textbooks cited at paras [23]-[26] above are to the effect that, if buildings on land are to be disregarded in fixing rent, an express provision to that effect is normally required. The word "express" means that a particular matter should be clearly stated; it is not enough if it appears from a strained and non-commercial construction of a provision that appears to contradict the remainder of the contract. In the present case, the wording of the fourth disregard, read with the remainder of clause THIRD and with the definition of the lease in clause FIRST, is anything but clear. In these circumstances we conclude that the disregard must be restricted in the manner suggested above.

[36] In our opinion the wording used in the fourth disregard can readily be construed in this manner. The disregard refers to buildings "erected" on and constructions "carried out" to the subjects of lease, but both of the quoted expressions can be interpreted as referring only to the future, not the past. That would accord entirely with the approach based on contrast, purpose and commercial common sense.

[37] Finally, we should note that the wording of the fourth disregard cannot in our opinion be construed as a result of striking a bad bargain. The disregard was introduced by the Minute of Agreement of 1990, which primarily operated as an assignation of the tenants' interest under the lease. Nothing in that agreement, which is very short, suggests that anything could have been given in exchange for the exclusion of buildings, or that the landlords might have miscalculated the benefits and detriments accruing to them as a result of the assignation. Equally, the introduction of the disregard in that Minute of Agreement

cannot be characterized as the outcome of negotiations, involving give-and-take by the parties. It stands on its own in what is otherwise an assignation of the tenants' interest.

Conclusion

[38] For the foregoing reasons we will allow the reclaiming motion and recall the interlocutors of the Lord Ordinary dated 5 February 2019 except in so far as the first of those interlocutors is limited to amendment of the pleadings. From this it follows that we will sustain the second plea in law for the defender and dismiss the action as irrelevant.