Compensating business tenants

Landlord and tenant Alexandra Lethbridge and Rachel Day review the statutory rights a business tenant has to compensation on termination of its tenancy.

There are a variety of situations in which a business tenant can obtain compensation from its landlord when it vacates its property at the end of a tenancy. Compensation may be payable under statutory provisions for disturbance, improvements and misrepresentation, although in certain limited circumstances rights to statutory compensation can be excluded by agreement between the parties.

Compensation for disturbance

Under the Landlord and Tenant Act 1954 (the 1954 Act) a tenant has a statutory right to renew its lease provided that it is in occupation for the purposes of its business at the relevant time and provided that the lease falls within the 1954 Act renewal provisions.

A landlord can oppose such a renewal, but only in certain circumstances. These can be found in section 30(1) of the 1954 Act and are categorised either as “fault” grounds or “no-fault” grounds. The distinction is important in establishing whether a tenant has a right to compensation, as if a lease renewal is successfully opposed on a fault ground, no compensation is payable. Fault grounds include a failure on the part of the tenant to repair or to pay the rent.

No-fault grounds arise in situations where the landlord wishes to refuse the grant of a new lease for strategic reasons. A landlord can refuse the grant of a new lease if it has a firm and settled intention to reconstruct, redevelop, or demolish the premises. This is commonly referred to as “ground (f)” because it derives from section 30(1)(f) of the 1954 Act. Demonstrating the necessary intention, and that there is a reasonable prospect of achieving that intention, is not an easy burden to discharge, but once the intention is shown, the court has no discretion – it must refuse to grant a new tenancy.

A landlord can also refuse the grant of a new lease where it intends to occupy the premises itself (commonly referred to as “ground (g)”). Again, a firm and settled intention needs to be demonstrated but a landlord cannot rely on this ground if it has owned its interest in the premises for less than five years.

Where a landlord successfully opposes the grant of a new lease on a no-fault ground, section 37 of the 1954 Act requires the tenant to be compensated for losing the value of its business premises. Compensation is calculated by applying a multiplier to the rateable value of the property. The multiplier can be specified by statutory instrument, and is currently set at one, but is doubled to two, where the tenant has been in occupation for the purposes of the same business for 14 years or more. This doubling will also be available where the identity of the tenant has changed but the tenant and its predecessors have been in occupation for more than 14 years, carrying out the same business. To qualify as the same business, there must be at least some transfer of goodwill between the different entities. A tenant will be entitled to receive the payment when it gives vacant possession to the landlord.

If the 14-year period of occupation is relevant for the calculation of compensation using the double multiplier, that 14-year period has to be satisfied as at the termination date specified in the 1954 Act notices. This could be later than the contractual expiry date. There are conflicting decisions on the effect of the tenant ceasing to occupy either mid-term or at the end of the lease. In Department of Environment v Royal Insurance [1987] 1 EGLR 83, the 14-year time period was strictly applied – 13 years and 363 days was held to be insufficient to qualify for the higher multiplier. In Bacchiocchi v Academic Agency Ltd [1998] 3 EGLR 157, it was held that whenever business premises are empty for a short time, it should not be held that business occupancy does not exist, as long as during the relevant period there is no alternative occupier or non-business usage.

Compensation will not be available where the tenant has been in occupation for less than five years: the length of occupation can, however, be aggregated with that of a predecessor carrying out the same business.

The parties can only contract out of the compensation provisions in narrow circumstances set out in section 38 of the 1954 Act. The parties can agree that compensation will not be paid after the right to that compensation has arisen, i.e. once the tenant has already given vacant possession.

Where the term of a lease is for five years or less, or where the tenant exercises a break right in order to leave before the end of five years, an exclusion clause can be
relied on to remove the right to compensation. Any agreement overstepping the exceptions described above will be void. If a lease does not have 1954 Act renewal rights, then compensation will not be available.

**Compensation for improvements**

Under section 1 of the Landlord and Tenant Act 1927 (the 1927 Act) there is potential for a tenant with a lease of business premises to obtain compensation for improvements. The compensation arises at the end of the lease and on the tenant “quitting the holding”, but is entirely separate from the 1954 Act compensation provisions. The person entitled to compensation is the tenant in possession: a tenant who has sublet the whole of its property cannot claim this compensation but there is doubt as to a tenant’s entitlement where it has sublet only part of its property.

Improvements that potentially carry an entitlement to compensation are those which “add to the letting value of the holding”. Certain types of alterations will not come within the definition of improvements, such as the tenant’s own fixtures, or improvements made pursuant to an obligation for which the tenant received valuable consideration, whether from the landlord or the tenant’s own undertenant. A claim for compensation will only arise where a tenant (or its predecessor) served a valid notice of its intention to carry out the improvements in accordance with section 3 of the 1927 Act, and either no objection was raised by the landlord, or in the case of an objection by the landlord, court authorisation was obtained. The tenant must then have carried out the improvements in accordance with the notice or any court authorisation.

If a potential entitlement to compensation arises, the claim for compensation must then follow procedural requirements: within prescribed time limits and in the prescribed manner. The claim must include the amount claimed. The maximum amount of compensation available will be the net addition to the value of the holding as a whole as a direct result of the improvement, or the reasonable cost of carrying out the improvement at the termination of the tenancy, whichever is the lesser sum.

**Compensation for misrepresentation**

Where misrepresentation or concealment of material facts by a landlord leads either to a court being induced to refuse an order for a new tenancy, or to a tenant quitting the premises after not making, or withdrawing, an application for a new tenancy, section 37A of the 1954 Act provides for compensation to be paid. Compensation will be an amount ordered by the court as being sufficient to compensate the tenant for the loss or damage sustained as a result of the order being refused or the tenant quitting the premises.

In *Inclusive Technology v Williamson* [2009] EWCA Civ 718; [2009] 3 EGLR 49, the landlord refused to grant the tenant a new lease because it intended to redevelop the property. The landlord subsequently decided not to proceed with its plans owing to a change in market conditions and an increase in the projected costs of the project, however it did not tell the tenant of the change in its plans. The tenant continued to believe that the landlord would be able to satisfy ground (f). Extra compensation was awarded in the light of the landlord’s unfair dealing.

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**WHY THIS MATTERS**

Landlords need to have careful regard to these compensation scenarios when considering their options in the run-up to lease expiry. Unforeseen claims from tenants can affect the viability of redevelopment or refurbishment plans.

**Compensation for disturbance**

Careful analysis should precede decisions about whether to oppose a 1954 Act renewal request and on what grounds. For example, compensation is only payable if the court specifies a no-fault ground as the reason a new lease has been refused. This requires a tenant application for a new tenancy to proceed to trial – expense and time which the tenant may not be willing to invest. A landlord may therefore gain by including both fault and no-fault grounds of opposition in 1954 Act proceedings.

For a tenant facing possible relocation at lease expiry, the availability and level of compensation may determine its strategy and assist with relocation and fit-out costs in a new location.

**Compensation for misrepresentation**

Compensation for misrepresentation is not calculated in the same way as for disturbance – it is a sum which appears sufficient for damage or loss sustained by the tenant as a result of the order being refused (section 37A(1) of the 1954 Act) or the tenant quitting the holding (section 37A(2) of the 1954 Act).

Landlords and their advisers must be careful in making statements about their intentions on which a tenant then relies. Where statements are made which amount to representations, they must remain true throughout the course of the proceedings. Where a landlord’s plans change, the landlord must alert the tenant or face a potential claim.

**Compensation for improvements**

Tenants should be aware that claims for compensation under the 1927 Act are rare. Even where the authorisation procedure has been followed, a compensation claim may fail because of future plans for the property. Where the property is to be redeveloped, or if a lease or licence for alterations requires the tenant to reinstate at the end of the term, no compensation will be payable as the landlord will not gain a residual value from the improvements.

On a more practical level, Schedule 3 to the 1927 Act may provide useful leverage for tenants to persuade a landlord to consent to alterations that are prohibited in the lease.