Neutral Citation Number: [2024] UKUT 371 (LC)

Case No: LC-2024-194

IN THE UPPER TRIBUNAL (LANDS CHAMBER)
AN APPEAL AGAINST A DECISION OF THE FIRST-TIER TRIBUNAL (PROPERTY CHAMBER)
FTT REF: LON/00BB/LSC/2023/0024

Royal Courts of Justice, Strand,
London WC2A 2LL

20 November 2024

TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

LANDLORD AND TENANT – BREACH OF COVENANT – conversion of building into flats without planning consent – whether term to be implied into lease that tenant would comply with legal obligations – s.168, Commonhold and Leasehold Reform Act 2002 – appeal allowed

BETWEEN:

ASSETHOLD LIMITED

Appellant

-and-

INTERFACE PROPERTIES LIMITED

Respondent

309 Barking Road,
London E13

Martin Rodger KC, Deputy Chamber President

19 November 2024

Sam Madge-Wyld, instructed by Scott Cohen Solicitors, for the appellant
James Sandham, instructed by Lester Dominic Solicitors, for the respondent

The following cases are referred to in this decision:

Attorney General of Belize v Belize Telecom Ltd [2009] UKPC 10; [2009] 1 WLR 1988
BP Refinery (Westernport) Pty Ltd v Shire of Hastings (1977) 180 CLR 266; [1977] UKPC 13
Daejan Investments Ltd v Benson [2013] UKSC 14; [2013] 1 WLR 854
Marks & Spencer plc v BNP Paribas Securities Services Trust (Jersey) Ltd [2015] UKSC 72
Philips Electronique Grand Public v British Sky Broadcasting [1995] EMLR 472

Introduction

1. Where a lease included a covenant by the tenant to indemnify the landlord against any liability in respect of legal obligations, but did not include an express covenant by the tenant that it would comply with all legal obligations pertaining to the property, was such a covenant nevertheless to be implied into the lease? That is the main issue in this appeal from a decision of the First-tier Tribunal, Property Chamber (the FTT).

2. The appellant, Assethold Ltd, is the tenant under a headlease for a term of 999 years of the upper floors of a building in Barking Road, Plaistow. The respondent, Interface Properties Ltd, is the owner of the freehold of the building and the appellant's landlord.

3. Neither of the parties was an original party to the headlease, which was granted in 2006. The appellant took a transfer of the unexpired term in 2017. By that time the first and second floors of the building had long since been divided into four flats each of which had been demised by a long sub-lease in 2007. Each of those sub-leases has subsequently been assigned. The respondent acquired the freehold in 2018.

4. The four flats were created without the benefit of planning consent. In 2010, before either of the parties or any of the current leaseholders became interested in the property, the local planning authority began enforcement action. It served enforcement notices on all those with interests in the building requiring that the use of the upper floors as four separate dwellings cease and that the upper floors be returned to a single flat. An appeal against that notice is believe to have been dismissed by a planning inspector in 2011 but the notices have never been complied with.

5. In October 2022 the respondent applied to the FTT for a determination under section 168 of the Commonhold and Leasehold Reform Act 2002 (the 2002 Act) that there had been a breach of covenant. The basis of the application was an allegation that, by failing to comply with the enforcement notice, the appellant had breached an implied term in the headlease.

6. In its decision handed down on 6 September 2023 the FTT determined that the headlease included an implied covenant by the tenant that it would at all times comply with "legal obligations" as that expression is defined in the headlease. The relevant definition is in clause 1.17 and provides:

> "Legal Obligation" means any obligation from time to time created by any Enactment or Authority which relates to the Property or their use and includes without limitation obligations imposed as a condition of any Necessary Consent

With the exception of the Property, none of the capitalised words used in the definition of Legal Obligation was itself defined elsewhere in the headlease.

7. The FTT also determined that the implied term had been breached by the appellant in that it had carried out unauthorised conversion works and had permitted the upper floors of the building to be used in breach of the enforcement notice.

8. Permission to appeal the FTT's decision was granted by this Tribunal. The grounds of appeal are that the FTT was wrong to imply a term into the headlease that the tenant would comply with legal obligations and wrong to find that the appellant had breached any such obligation. The FTT had refused to grant the appellant's request for orders under section 20C, Landlord and Tenant Act 1985 and paragraph 5A, of Schedule 11, 2002 Act, protecting it against any obligation to contribute to the respondent's costs of the proceedings through a service charge or administration charge and the appellant was also granted permission to appeal against that part of the decision.

The headlease

9. No. 309 Barking Road in Plaistow is part of a terrace with commercial premises on the ground floor and residential flats above. It is on basement, ground and two upper floors and is said formerly to have been a doctor's surgery with ancillary accommodation. The ground floor is now used as a hairdresser and the upper floors are residential.

10. The headlease is described on the title page of the document as a "Residential Lease". The original parties were Caphill Developments Ltd as landlord and Jeevan Singh as tenant. It was granted on 30 October 2006 for a term of 999 years and comprises the two upper floors of No.309 and the roof space, with the landlord retaining the commercial unit on the ground floor and basement of the building which have their own separate entrance. Only a peppercorn rent was reserved by the headlease, and no premium is recorded in the prescribed particulars as having been paid. No rights over the property were reserved in the landlord's favour and the only benefits which it appears to have obtained on granting the headlease were the right to insure the building and to recover a contribution towards the cost from the tenant, the right to a contribution towards the maintenance of certain parts of the building, and a number of indemnities.

11. Clause 3 of the headlease comprised the tenant's obligations. These included payment of the peppercorn rent, the insurance charge "by way of future rent", any outgoings, and a contribution to the cost of repairing party structures and things used or shared with other property (the last being clause 3.5).

12. Clause 3.7 contained the first of three separate indemnities, and was expressed as follows:

> The Tenant shall indemnify and keep indemnified the Landlord against all liability in respect of Legal Obligations.

13. Clause 3.8 was a second indemnity, expressed in slightly different language: "By way of indemnity only and not further or otherwise, the Tenant shall observe and perform all covenants in respect of the Property arising from the Title Matters […]". Once again, the expression "Title Matters" was not defined elsewhere in the document, so it is doubtful whether the second indemnity has any meaning.

14. The third and final indemnity, given by the tenant in clause 3.10, covered uninsured damage to the Property, or to persons or property, arising out of the state of repair or condition of the Property, any development carried out by the tenant, anything the tenant might attach to the Property, and the action of the tenant, any underlessee, or their respective servants or agents.

15. Apart from an express covenant for quiet enjoyment, the landlord's only obligations in the headlease were to insure the building and any plant, and to maintain retained land (which included the commercial parts).

16. The headlease also includes an unusual form of forfeiture clause. It is entitled to recover possession of the property under clause 4 if the tenant is at least 21 days late in paying the rent (which includes the insurance charge and not simply the peppercorn) or if the tenant "has perpetually broken any of the terms of the lease". Perpetual means continuing for ever and it is not at all clear when this forfeiture condition would be taken to be satisfied.

17. Finally, amongst other provisions at the end of the headlease, clause 7.3 was an exclusion clause in the following terms:

> "Nothing in this Lease shall imply or warrant that the Building may lawfully be used for any use and the Tenant acknowledges and admits that no such representation or warranty has ever been made by or on behalf of the Landlord."

The FTT's decision

18. The FTT's decision dealt with a number of distinct applications. It began its consideration of the application under section 168, 2002 Act by reminding itself of the conditions which must be satisfied before a term to be implied into a contract. Its concise summary was an edited version of the formulation by the majority of the Privy Council given by Lord Simon of Glaisdale in *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* [1977] UKPC 13:

> "(1) it must be reasonable and equitable; (2) it must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it; (3) it must be so obvious that 'it goes without saying' (4) it must be capable of clear expression; (5) it must not contradict any express term of the contract".

As Lord Simon explained, these conditions may overlap. The FTT referred additionally to guidance on the application of these conditions provided by Lord Neuberger of Abbotsbury PSC in *Marks & Spencer plc v BNP Paribas Securities Services Trust (Jersey) Ltd* [2015] UKSC 72.

19. Having referred to the terms of the headlease and noting that the subleases of individual flats included covenants by the subtenants to comply with all legal obligations and not to breach planning control (which it described as "normal and usual") the FTT continued:

> "36. As stated above, an express covenant by the tenant to *comply* with legal obligations (as well as indemnify the landlord) would be normal and acceptable in current commercial leases and its omission in the present case is highly unusual.
>
> 37. In view of the fact that the [appellant] is obliged by the lease to indemnify the [respondent] against its breaches of legal obligations it must be implicit that the tenant will comply with those legal obligations in order to prevent incurring liability under the indemnity clause. The inclusion of the indemnity clause without the tenant's accompanying promise to comply with the legal obligations makes no sense and even the officious bystander would have questioned its omission.
>
> 38. On that basis the tribunal concludes that the headlease must have intended to contain an implied covenant by the tenant that the tenant would at all times comply with legal obligations as defined in definition 1.17 of the lease.
>
> 39. The Tribunal therefore finds that such a covenant is to be implied in the head lease in this case. That implied covenant which is a promise by the tenant 'to comply with "legal obligations" as defined in definition 1.17 of the lease', has patently been broken by the [appellant] carrying out unauthorised conversion works and continues to be broken by their conduct in permitting the upper floors of the property to continue to be used for residential accommodation contrary to the enforcement notice […]"

The implication of terms into a contract

20. As Lord Neuberger explained in *Marks & Spencer plc v BNP Paribas*, at [15], there are two different types of implied term. The most common type of implied terms are those which the law implies as an incident of a particular legal relationships (such as landlord and tenant or employer and employee) unless the parties have expressly excluded them; examples are the landlord's implied covenant for quiet enjoyment which is a term of every letting, or the repairing covenant implied into leases by the Landlord and Tenant Act 1985. In its section 168 application to the FTT the respondent claimed that the appellant was bound by a covenant not to use the property for any illegal purpose because that was "implied by the relationship of landlord and tenant created by the lease". If that was intended to suggest an argument that a covenant not to use the demised premises for an illegal purpose is implied into every lease, it was rightly not pursued; no such term is implied by law.

21. The second variety of implied terms is a term implied into a particular contract by the court or tribunal, in the light of the express terms of the contract, commercial common sense, and the facts known to both parties at the time the contract was made. It was this sort of implied term which the FTT found in the headlease.

22. The test for implying such a term is a strict one. The term must be necessary to give business efficacy to the transaction, or (which will generally be the same thing) it must be so obvious as to go without saying. The question is not what is reasonable. In *Marks & Spencer plc v BNP Paribas*, at [77], Lord Clarke JSC said that "[a]nother way of putting the test of necessity is to ask whether it is necessary to do so in order to make the contract work". The strictness of the requirement of necessity means that implied terms are rare,

especially in professionally prepared documents. Usually there are none, as Lord Hoffmann pointed out in *Attorney General of Belize v Belize Telecom Limited* [2009] 1 WLR 1988, at [17]:

> "The question of implication arises when the instrument does not expressly provide for what is to happen when some event occurs. The most usual inference in such a case is that nothing is to happen. If the parties had intended something to happen, the instrument would have said so. Otherwise, the express provisions of the instrument are to continue to operate undisturbed. If the event has caused loss to one or other of the parties, the loss lies where it falls."

23. The conditions which must exist for a term to be implied into a particular contract, including a lease, are those which Lord Simon identified in the *BP Refinery* case, in the passage which the FTT quoted in its decision. In *Philips Electronique Grand Public v British Sky Broadcasting* [1995] EMLR 472, 481, (cited by Lord Neuberger in *Marks & Spencer v BNP Paribas*) Sir Thomas Bingham MR referred to Lord Simon's formulation as one which "distils the essence of much learning on implied terms." In its decision, the FTT omitted half of Lord Simon's second proposition (business efficacy), leaving out the important explanation "that no term will be implied if the contract is effective without it". Subject to that restoration the summary is a sufficient statement of principle for the purpose of this appeal.

The appeal

24. The appellant was granted permission to appeal on four separate grounds, namely:

    1. That the decision to imply a term was obviously wrong and contrary to authority.
    2. That the finding that the appellant had carried out the unauthorised conversion works was unsupported by the evidence and was wrong.
    3. That the FTT had not considered or dealt with the appellant's case explaining why, if there was an implied term, it had not breached it.
    4. The FTT had given no explanation for refusing the appellant's application for orders under section 20C and paragraph 5A.

25. For the appellant, Mr Madge-Wyld submitted that the FTT's decision to imply a term was contrary to the principles it had identified. In particular, the implication was not necessary, it was inconsistent with the express term which the parties had agreed in clause 3.7 in that it added a further consequence of a breach of any Legal Obligation when the parties had already provided for the indemnity, and that the suggested term was one which could be expressed in a number of different ways with differing effects.

26. For the respondent, Mr Sandham submitted that the FTT had been correct to imply a term for the reasons it gave, namely that it was obvious that the parties must have intended that the general law, including planning law, would be complied with in relation to the property and that the parties must therefore have intended not only that the appellant would indemnify the respondent in the event that it suffered a loss as a result of a breach

of the general law, but additionally that it would enter into a positive obligation of its own to comply with the law, which could be enforced directly by the respondent. The FTT's conclusion derived further support, Mr Sandham suggested, from clause 7.3 which it had not mentioned. This showed that the freeholder took no responsibility for the use of the premises, and it was consistent with that express agreement that the parties must have taken it as read that the tenant would be liable to comply with any statutory limitations on the use of the premises.

27. I am unable to accept Mr Sandham's submissions and in my judgment the FTT's conclusion that the headlease included the implied term is unsustainable.

28. The bedrock of the FTT's reasoning was that the inclusion of a covenant requiring the tenant to comply with relevant legal obligations was normal. It noted the express inclusion of such a covenant in the occupational subleases describing it as normal, usual, and rarely omitted. It considered an express tenant's covenant to comply with legal obligations to be "normal and acceptable in current commercial leases" and regarded its absence from the headlease as "highly unusual". But the fact that a particular form of obligation is usually found in a contract of a particular type is of questionable relevance when it comes to the implication of terms; if anything, the absence of a covenant which would ordinarily be expected to be included in a lease is an indication that the parties did not intend it to be part of their arrangement. The routine inclusion of a particular term in other leases demonstrates that the term is not so obvious that it goes without saying, quite the contrary, and its omission in a specific example suggests a conscious decision to leave it out, not a confident consensus that it is unnecessary to include it.

29. The other difficulty with the FTT's reference to what might routinely be included in commercial leases is that it pays no regard to the unusual features of this particular agreement. The FTT did not mention that the headlease was for a term of 999 years, nor that the rent was a peppercorn yet no premium was paid, nor that it included a forfeiture clause which could be invoked only when the terms of the lease had been broken "perpetually". These are not the terms of a typical commercial lease.

30. The second strand of the FTT's reasoning was that because the tenant had agreed to indemnify the landlord against "its breaches of legal obligations" it must be implicit that the tenant would comply with the same obligations "in order to prevent incurring liability under the indemnity clause". But the indemnity was not an indemnity against breaches of "its", i.e. the tenant's, legal obligations, it was an indemnity against "all liability" in respect of legal obligations. If the landlord sustains loss as a result of a breach by any person of any statutory or regulatory obligation, the tenant is obliged to indemnify it against that loss. It does not seem to me to follow at all that the tenant would therefore be prepared or expected additionally to covenant that it would not breach a legal obligation.

31. The express indemnity will protect the landlord from any loss arising out of the unlawful use of the property or the breach of any other obligation relating to it. If such a breach occurs, but does not cause any loss to the landlord, the indemnity will not be invoked. One important difference between an obligation to indemnify such as the parties expressly agreed, and the covenant to comply with legal obligations which the FTT implied, is that the landlord would have a cause of action for breach of the implied covenant whenever a breach occurred, whether or not it had sustained any loss as a result. The inclusion of an

indemnity as a protection for a freeholder which has disposed of its entire interest in the upper floors of the building while retaining the ground floor is perfectly understandable. But it is equally understandable why the intermediate tenant, who will not be in occupation, would not wish to assume an obligation to the freeholder which might require it to take action for the benefit of the freeholder, whether or not it wished to do so in its own interests. There is simply no causal connection between the agreement of one form of protection and the suggested inevitability that the parties intended the unspoken inclusion of the other.

32. The suggested implied term satisfies none of the conditions identified by Lord Simon in the *BP Refinery* case.

33. It has been said that whether a proposed term is reasonable and equitable is rarely decisive, and in some more recent formulations of the conditions it has been dropped (see *Lewison: The Interpretation of Contracts,* 8th Ed., para 6.79). In any event, whether a term is reasonable should be judged from the point of view of both parties to the contract and in circumstances where the freeholder has retained so little interest in the demised premises the tenant under the headlease might well take a different view about the reasonableness of a positive covenant.

34. The suggested term is far from being necessary to give business efficacy to the headlease, which will work perfectly well without it. The FTT did not explain why it thought this condition might be satisfied and nor did Mr Sandham. The suggestion that the inclusion of the indemnity clause without an accompanying tenant's promise to comply with legal obligations "makes no sense" is muddled and illogical and appears to have been based on an assumption that the implied covenant was some form of protection for the tenant "to prevent incurring liability". But the landlord would be able to recover its losses under the indemnity whether or not it had the additional protection of a direct covenant, and while the tenant might wish to take steps of its own to avoid having to pay out on the indemnity, it might equally prefer to wait and see if loss might be avoided without it having to become involved.

35. The proposed term is capable of clear expression, but the FTT seems to have imagined it in different forms. In paragraph 38 it said the term was the tenant would at all times comply with legal obligations as defined in clause 1.17 of the lease, but in the following paragraph it said that the term was breached by the appellant permitting the upper floors of the property to continue to be used for residential accommodation. A covenant not to do something is different from a covenant not to permit something to be done by someone else, and the breach which the FTT found was of the latter type. It did not explain why it preferred one formulation over the other.

36. The implied term is inconsistent with the express terms of the agreement in which the parties considered the consequences of a breach of legal obligations. The agreed consequence was stated in clause 3.7 – the tenant would indemnify the landlord for loss which it suffered. That must be understood as the limit of the consequences which the parties intended. They cannot be taken additionally to have contemplated that the tenant would be liable to the landlord in damages or be at risk of an injunction or forfeiture even if no loss was sustained by the landlord. Clause 7.3, on which Mr Sandham relied, is another example of the parties having thought about the possibility that some uses of the

building might not be lawful. Far from strengthening the case for implying a term, clause 7.3 allocates risks and draws a clear line which the suggested term would cross. The clause confirms that no warranty is given, nor representation made that the building may lawfully be used for any particular use. The risk that its intentions for the property may not be lawful is left with the tenant alone; it would vary the parties' bargain if, in addition to assuming that risk, the tenant is taken additionally to have covenanted to comply with legal obligations.

37. For these reasons I agree with Mr Madge-Wyld that the FTT's decision was wrong and that the headlease includes no such implied term. The appeal on ground 1 is allowed.

38. It was no part of the respondent's application that the appellant had been responsible for the division of the property into four flats, and it is therefore common ground that the FTT's finding that the implied term had "patently been broken by [the appellant] carrying out unauthorised conversion works" was wrong in any event. The appellant did not acquire the headlease until more than ten years after the conversion works were completed.

39. As the headlease did not include the implied term, it is unnecessary to consider the second and third grounds of appeal.

40. The fourth ground of appeal concerns the FTT's refusal to make orders under section 20C, Landlord and Tenant Act 1985 and paragraph 5A, of Schedule 11, 2002 Act, and its omission of any explanation why. On reflection, Mr Madge-Wyld acknowledged that the underlease does not include any term which would enable the respondent to recoup its costs of the proceedings as a service charge, so an order under section 20C is unnecessary and need not be considered further. I think it equally unlikely that the respondent has the right to recoup any part of its costs from the appellant as an administration charge, but rather than dwelling on that point, and as the appellant has successfully reversed the only part of the decision which was adverse to it, it would be is appropriate for an order to be made under paragraph 5A in respect of the costs of the proceedings before the FTT and the costs of the appeal. Mr Sandham did not resist that course and I so direct.

Martin Rodger KC,

Deputy Chamber President

20 November 2024

Right of appeal

Any party has a right of appeal to the Court of Appeal on any point of law arising from this decision. The right of appeal may be exercised only with permission. An application for permission to appeal to the Court of Appeal must be sent or delivered to the Tribunal so that it is received within 1 month after the date on which this decision is sent to the parties (unless an application for costs is made within 14 days of the decision being sent to the parties, in which case an application for permission to appeal must be made within 1 month of the date on which

the Tribunal's decision on costs is sent to the parties). An application for permission to appeal must identify the decision of the Tribunal to which it relates, identify the alleged error or errors of law in the decision, and state the result the party making the application is seeking. If the Tribunal refuses permission to appeal a further application may then be made to the Court of Appeal for permission.