Avoiding Business Protection under Part II by Default

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This article considers a unique way in which parties to a business subtenancy may find that, despite their intentions, their subtenancy fails to attract the statutory protection of Part II of the Landlord and Tenant Act 1954. This can occur where, under the business headlease, the parties have excluded Part II and where the tenant purportedly grants a sublease of longer duration than that of the residue of the headlease. In such a case, an assignment by operation of law of the excluded headlease will occur in favour of the subtenant who, as an assignee of the headlease, will become subject to its terms and have no Part II protection.

It is trite law that the parties to a business tenancy can avoid statutory protection under Part II of the Landlord and Tenant Act 1954 by expressly contracting out of Part II. The mechanism under s.38A, which was introduced in 2003 (amending the process set out in the 1954 Act) allows parties to exclude protection provided the lease is for a fixed term and: (1) the landlord serves a warning notice on the tenant explaining that the tenant's rights are being excluded; (2) the tenant makes either a simple or statutory declaration to acknowledge it understands the consequences of contracting out; and (3) the lease includes an endorsement referring to the landlord's notice and the tenant's declaration and the parties' agreement that the relevant provisions of the 1954 Act are to be excluded from the lease.

Alternatively, whether expressly created or by implication of law, a tenancy at will can be used so as to avoid Part II: see, for example, *Hagee (London) Ltd v AB Erikson and Larson* [1976] QB 209; *Wheeler v Mercer* [1957] AC 416. Further, it is also possible to create a licence as opposed to a tenancy of business premises, which similarly may ensure that the benefits conferred on tenants by Part II of the 1954 Act are avoided: see, for example, *Esso Petroleum Co Ltd v Fumegrange Ltd* [1994] EGLR 91, which applied the *Street v Mountford* [1985] AC 809 principles governing the lease/licence distinction to commercial occupancy agreements. The courts, however, have been astute to expose sham licence agreements which have been used simply as devices to deny genuine tenants statutory rights under the 1954 Act. A landlord may, therefore, be more inclined to exclude Part II by creating a short fixed-term lease not exceeding six months (with no provision for extension): see, s.43(3) of the 1954 Act. The practical difficulty, however, of adopting this device as a method of avoiding security is that it may prove difficult for a landlord to find a potential tenant willing to enter into a tenancy for such a short duration.

Business subtenancy

In *Parc (Battersea) Ltd (In Receivership) v Hutchinson* [1999] 2 EGLR 33, the claimant granted to a company (Monarun Ltd) a lease of land in Battersea, London, for a fixed term expiring on 31 March 1998. The lease was excluded from the operation of ss.24-28 of the 1954 Act. On 8 December 1997, Monarun made an oral agreement with the defendant that the defendant should rent part of the land leased to Monarun for the purpose of his business, paying Monarun £300 per month. It was expressly agreed that Monarun would not serve notice to quit expiring before 31 March 1999. The defendant remained in occupation after the expiry of the headlease to Monarun and resisted the claimant's claim to possession on the ground that his subtenancy was one to which Part II of the 1954 Act applied.

It was agreed that the 1954 Act would only have application so as to benefit the defendant if the relationship between the parties was one of landlord and subtenant. The claimant, relying on the ruling in *Milmo v Carreras* [1946] KB 306, argued that the disposition effected by Monarun, being for a period equal to or (as in the instant case) in excess of the residue of the headlease, could only take effect as an assignment, albeit by operation of law, of the headlease and that, as the headlease was outside the provisions of Part II, this excluded lease had been assigned to the claimant. On this analysis, it was argued that the defendant held a sublease without Part II protection and rights of statutory continuation. In response to this argument, the defendant claimed that he had received from Monarun a subtenancy which operated independently of the headlease and that this survived the collapse of the headlease by effluxion of time and, being a monthly periodic tenancy, attracted the protection conferred by Part II. The defendant contended that there was no assignment by operation of law because the written formalities required by ss.52 and 53 of the Law of Property Act 1925 had not been complied with.

On the basis of the ruling in *Milmo,* Moore-Bick J held that an assignment by operation of law did not, in the instant case, require the formality of writing as the subtenancy would have been effective under s.54(2) of the 1925 Act as a legal lease (being at the best rent obtainable, not in excess of three years, without fine and taking effect in possession). This made it possible for there to be an assignment of the headlease by operation of law. Moreover, the headlease, being so assigned, meant that the defendant took possession subject to its provisions and limitations, one of them being that Part II did not apply. Accordingly, the defendant was held to be without protection under Part II and was required to give up possession.

Residential subtenancy

The ruling in *Parc Battersea* is not quite as unique as it first appears. A similar point has arisen in the context of subtenancies of residential properties. In *Grosvenor Estates Belgravia v Cochran* [1991] 2 EGLR 83, the appellant obtained the subtenancy of a flat from a company which itself held a lease of the whole of the building. Shortly before the expiry of the headlease, the company had sublet the flat to the appellant for a term of three years and the appellant thereafter spent a large sum of money on refurbishment. When the landlord sought possession of the flat, the appellant argued that the agreement that purported to grant her a subtenancy took effect as an assignment of the residue of the headlease and that, as a result, she had obtained a protected tenancy under Part I of the 1954 Act (providing security of tenure to long residential tenancies at a low rent).

In order, however, to qualify as a protected tenancy under Part I, it was necessary for the flat to have been let under a tenancy agreement "as a separate dwelling". If the agreement between the company and the appellant, which related to the flat alone, took effect as a subtenancy, that requirement would have been satisfied. However, because the period of the agreement exceeded the remainder of the term of the headlease, it was held to have operated as an assignment of the headlease in relation to that part of the building she occupied and, since the headlease related to the whole building, the flat was not protected. In the words of Ralph Gibson LJ, at 85, "the flat was not let to the appellant or to anyone else as a separate dwelling: it was let under the headlease with the rest of the premises . . . if the appellant was in occupation of the flat at the material time she clearly occupied it as a separate dwelling, but that is not the test."

Conclusion

Normally, of course, an assignment has to be made by deed, in compliance with s.52(1) of the 1925 Act, to be legally effective. In *Parc Battersea*, however, the oral subtenancy took effect by operation of law under s.53(1)(a) of the 1925 Act. It fell within the requirements of s.54(2) (i.e., being not in excess of three years, at the best rent obtainable and taking effect in possession) and, under the rule in *Milmo*, took effect by operation of law as an assignment of the headlease relating to that part of the premises. The legal consequence of this analysis was to deprive the subtenant of the statutory protection afforded by Part II.

Interestingly, however, had the subtenancy in this case not been granted for a period which exceeded Monarun's reversion under the headlease (so as not to take effect as an assignment by operation of law), the subtenancy to the defendant would have been capable of falling within Part II even though the headlease itself was excluded from protection. This would have been the outcome even if the subtenancy had been granted in breach of the terms of the headlease: see, *D'Silva v Lister House Developments Ltd* [1971] 1 Ch 17, at 32-33. The point has been made most recently in *Faiz v Burnley Borough Council* [2020] EWHC 407 (Ch), at first instance, where HH Judge Halliwell (sitting as a judge of the High Court), stated, at [5]:

> "If the Council's rights of forfeiture have been waived and, on the scheduled date of expiry, SASSF is in occupation for the purposes of a business under a sub-tenancy, SASSF could be entitled to security of tenure under the provisions of ss.24 to 28 of the Landlord and Tenant Act 1954 notwithstanding that the parties to the lease agreed to exclude such provisions under s.38A of the Act: *D'Silva v Lister House Developments Ltd* [1971] 1 Ch 17. This is on the basis that, following the expiry of the lease, SASSF would remain in occupation under a separate tenancy. It would, of course, be open to the Council to argue that the sub-tenancy was for the same term as the lease itself and thus took effect as an assignment of the lease, *Parc Battersea Ltd v Hutchinson* [1999] 2 EGLR 33."

This last observation is particularly significant as it suggests that the *Milmo* rule remains good law despite the somewhat controversial decision in *Bruton v London & Quadrant Housing Trust* [2000] 1 AC 406, where the House of Lords upheld the existence of a purely contractual tenancy with apparently no proprietary characteristics. Whilst the decision is difficult to reconcile with the proposition that a tenant who purports to grant a sublease for a term equal

to, or greater than, his own will be treated as having effected an assignment of his lease by operation of law, the *Milmo* rule has continued to be applied without reservation in subsequent case law. Apart from the passing reference in *Faiz*, above, it has been judicially recognised in *PW & Co v Milton Gate Investments Ltd* [2003] EWHC 1994 (Ch), where Neuberger J was called upon to consider whether a landlord and tenant could validly contract out of the normal consequences of the determination of a sub-tenancy on the service of a break notice terminating the headlease. In the course of his judgment, his Lordship expressly alluded to the inherent proprietary nature of a lease which would inevitably sometimes produce legal results which did not accord with the plain contractual intention of the parties. A classic example, in his view, arose when a tenant, who purports to grant a person a sub-tenancy for a term equal to, or greater than, the term of his own tenancy, will in fact thereby assign his tenancy to that person, even though both parties clearly intended the arrangement to be a sub-tenancy: see, at [81]. Thus, just as a tenant could not grant a sub-tenancy for a term equal to, or greater than, his sub-tenancy, so a tenant could not effectively agree with his landlord that any sub-tenancy will survive the expiry of the headlease according to its terms.

Interestingly, in *Mexfield Housing Co-operative Ltd v Berrisford* [2011] UKSC 52, a decision of the Supreme Court, Lord Neuberger had occasion to make a similar observation: " . . . in *Milmo v Carreras* [1946] KB 306, the Court of Appeal (led by Lord Greene MR) held that what was plainly stated and understood by the parties to be an underlease operated as an assignment of the lease as a matter of law, because the duration of the purported underlease equalled or exceeded that of the lease." Later in his judgment, his Lordship makes the point that the *Bruton* case was essentially about relativity of title with no bearing on a case where the nature of the agreement was such that it could not, as a matter of law, be a tenancy even as between the parties: see, at [65]. There is little doubt, therefore, that, *Milmo* and *Parc Battersea* remain good law on the current state of the authorities.

The law is stated as at 7 December 2021.