CHANCERY BAR

Response of the Chancery Bar Association to the Law Commission's Consultation on its Thirteenth Programme of Law Reform

Introduction

1. The Chancery Bar Association is one of the longest established Bar Associations and represents the interests of over 1,200 members handling the full breadth of Chancery work at all levels of seniority, both in London and throughout England and Wales. It is recognised by the Bar Council as a Specialist Bar Association. Full membership of the Association is restricted to those barristers whose practice consists primarily of Chancery work, but there are also academic and overseas members whose teaching, research or practice consists primarily of Chancery work.

2. Chancery work is that which is traditionally dealt with by the Chancery Division of the High Court of Justice, which sits in London and in regional centres outside London. The Chancery Division attracts high profile, complex and, increasingly, international disputes. The Companies Court itself deals with some 12,000 cases each year.

3. Our members offer specialist expertise in advocacy, mediation and advisory work including across the whole spectrum of company, financial and business law. As advocates members are instructed in all courts in England and Wales, as well as abroad.

4. This response is the response of the Association to the Law Commission's Consultation on its Thirteenth Programme of Law Reform. This response has been led by Tim Fancourt QC, Andrew Twigger QC, Cecily Crampin, Oliver Radley-Gardiner and Dr Duncan Sheehan. The topics set out below have been selected following a request for suggestions made to all members of the Association. The authors of the sections below are shown in the footnotes.

Commercial Leasehold Law[1]

5. The law of landlord and tenant has one predominant issue at the current time. It is distorting and impeding the normal functioning of the property market (the commercial market in particular, though the issue is not limited to commercial leases). The issue is whether, under the Landlord and Tenant (Covenants) Act 1995, a guarantor of a former tenant can validly enter

[1] Timothy Fancourt QC

into either a guarantee of either the new tenant's liability or a sub-guarantee of the former tenant's guarantee of the new tenant's liability; and, further, whether the lease can be validly assigned to the guarantor.

6. The issue arises routinely where a lease has been granted to a single purpose vehicle or a property holding company and the real value in the tenant's covenant is supplied by a parent company guarantee. Upon a corporate re-organisation, there was previously rarely an objection from a landlord to an assignment of the lease to another group company provided that the guarantor remains a guarantor or becomes the tenant, since that preserves for the landlord the full investment value and guarantees the income stream. A similar issue arises on an assignment by partners of leases, upon admission or retirement of a partner.

7. Recent decisions have identified that an existing guarantor cannot stand as guarantor for an assignee of the lease[2] or become the tenant by assignment[3]. The parties cannot agree otherwise or evade these consequences.[4] This is plainly contrary to business common sense and impractical. Obiter dicta in one case suggest that a guarantor can sub-guarantee the authorised guarantee agreement made by the former tenant, but this is cumbersome and unsatisfactory in terms of preserving asset value. Moreover, where the assignee is a further SPV it means that upon a second assignment there will be no guarantee of substantial value available. The result is that landlords are reluctant to agree assignments of existing leases or grant leases to tenants using parent guarantees for insubstantial tenants. The issue arises frequently and will cause problems generally upon grant and assignment of leases where a guarantor for the tenant is required.

8. It is suggested that the law urgently needs to be reformed, to make it unambiguously clear that guarantors can agree to be the guarantor of an assignee or take an assignment of the lease themselves. The provisions of the 1995 Act were (it is suggested) intended to ensure that tenants are fully released from liability on assignment, by ensuring that a guarantor is released at the same time, thereby avoiding an indemnity claim against the tenant. This principle has no proper application where a guarantor is willing to stand again as guarantor to facilitate an assignment of the lease, but the 1995 Act has been interpreted as having the effect of applying

[2] *K/S Victoria Street v House of Fraser*, a decision of a very strongly constituted Court of Appeal.
[3] *EMI Group v O&H*, a first instance decision understood to be subject to a pending appeal.
[4] *UK Leasing Brighton v Topland Neptune* [2015] 2 P&CR 2.

the principle where it is not needed.

9. It is understood that the Property Litigation Association has drafted an amendment to s.24 of the 1995 Act that will reverse this effect. The problem is easily addressed and will not take up a great deal of the Commission's time. The ChBA supports the principle of the amendment.

10. As far as Part II of the Landlord and Tenant Act 1954 is concerned, others will be better placed to advise the Law Commission whether the existence of security of tenure remains a necessary and desirable aspect of business tenancies for tenants themselves. However, the number of tenants who oppose landlords' attempts under the Act to resume possession suggests that continuity of business occupation remains important. The cost of fitting out shops and offices is so high that one can well understand tenants' desire to keep the same premises for the duration of renewed tenancies. That is particularly important today where it is normal for business leases to be as short as 5 year terms, and almost never more than 10 years.

11. The existing model of security of tenure provided by the 1954 Act has stood the test of time and proved itself to strike a reasonable balance between the interests of landlords and tenants. It was last amended, successfully, in 2003, when improvements to the slightly cumbersome process of applying for and obtaining a new tenancy were introduced. The parties now have ample opportunity to agree terms for a new tenancy without having to start court proceedings, or indeed to make use of the PACT (professional arbitration on court terms) scheme, which is an ad hoc arbitration carried out by agreement of the parties while court proceedings are stayed. We therefore consider that changes in the scheme of security of tenure are not merited at this time. We are not aware of particular technical amendments that are considered necessary, but if the Commission is aware of some we will happily comment on them.

Residential Leasehold Law[5]

12. In relation to the proposed examination of the existing regulation of service charges payable by tenants of long leases, we consider that the following points are particularly significant in terms of their practical impact.

[5] Cecily Crampin

The Landlord and Tenant Act 1985

13. Section 20ZA(2) of the LTA 1985 defines "qualifying works" as "works on a building or any other premises". The term "works" is not defined, and the definition is circular. The definition is also unhelpful, as it makes it difficult for a landlord to know whether proposed works fall within the section or not.

14. Even following the decision of the Court of Appeal in *Phillips v Francis* [2014] EWCA Civ 1395 there remains uncertainty about when proposed works should be grouped together and so when the £250 limit is engaged. We consider that this needs to be clarified urgently.

15. Section 20(ZA)(2) defines Qualifying Long Term Agreement as an agreement entered into by or behalf of the landlord or superior landlord for a term of more than 12 months. There is uncertainty as to the scope of this provision. For example, it is not clear whether it would apply if a landlord entered into an ongoing contract with no specified termination date.

16. Notwithstanding the decision in *BDW Trading Limited and Another v South Anglia Housing Limited* [2013] WLR (D) 282, there is also uncertainty as to whether a landlord is obliged to follow the consultation procedure if the QLTA is entered into before leases are granted including, in particular, whether a landlord is required to consult when agreements for lease have already been entered into. We find that this problem occurs more and more with buildings with "green" concepts, such as multi-block estates with hard-wired hot water and heating, where the block must take its hot water services from a central system. That commitment is usually made in advance of there being any qualifying tenants, and it is not easy to reconcile with the existing consultation machinery

Service charges held by the Landlord

17. The new sections 42A and 42B of the LTA 1987 introduced by section 156 of the CLRA 2002 are still not in force. This causes dissatisfaction amongst tenants and can provoke distrust of landlords, precipitating unnecessary tribunal proceedings. Bringing these sections into force would bring greater clarity and transparency.

18. Where a tenant has paid service charges that turn out to be in excess of his contractual liability,

it is unclear what remedies are available to the tenant to recover those charges, in particular what restitutionary remedies are available, and when the defence of change of position will be available to the landlord. The situation is made more complex still where the landlord (or managing agent) changes while the service charges are being held, and it may not even be clear who the tenant should pursue. A statutory regime could provide a clear mechanism for recovering overpayments. Finally, limitation periods for such monies remain a fertile, and unnecessary, source of dispute.

Leasehold covenants relating to service charges

19. Much service charge litigation turns not on the question of reasonableness under s19 of the Landlord and Tenant Act 1985, but on questions of construction of the service charge clauses and the landlord's maintenance obligations in the occupational leases. Arguments about construction of those clauses can often be used by both sides in the litigation, despite the original dispute being more focused on the perceived need for the works. Many Lands Chamber appeals often include questions of construction of leases.

20. Old style leases, with limited service charge clauses, including in service charge costs only those for repair, maintenance and decoration for example, are usually construed restrictively (following lines of authority interpreting commercial lessee repairing obligations restrictively). For example, leases with relatively limited service charge clauses may prevent landlords recovering costs of replacing plant such as lifts and the end of their economic life, and/or recovering costs of complying with Building Regulation requirements or best practice as to minimising fire risks.

21. This can be particularly problematic in lessee owned blocks, where on enfranchisement the lessees inherit old style leases. If one lessee resists, it may be hard to get agreement to variations of all the leases. Any litigation about construction or any application to vary leases under the Landlord and Tenant Act 1987 (provisions that seem rarely used) will have to be at the cost of the lessee-owned company, which is likely to have few funds. Similar problems arise with RTMs.

22. Old style leases often have service charge machinery which is likewise outwith the common current practice of advance and balancing charges across a service charge year.

23. One solution would be implied terms allowing inclusion in service charge costs of the costs of works of the type mentioned above, or at least of compliance with Building Regulations and similar. An alternative, which would address the problems in lessee-owned freeholds, would be to make the revision of service charge provisions to leases to a standard form (plus any variations the parties wished) a statutory part of collective enfranchisement.

24. Following the decision in *Freeholders of 69 Marina v Oram* [2011] EWCA Civ 1258, it would be useful to clarify whether, where a lease reserves service charge as rent, a landlord who wishes to forfeit for non-payment of rent is required to serve a notice under section 146 of the Law of Property Act 1925.

25. Finally, in light of the decision of the Supreme Court in *Arnold v Britton* [2015] UKSC 36, it would also be useful to consider whether there ought to be some statutory control over non variable service charges which are unreasonable in amount.

Right to Manage

26. It is a shame that the no-fault right to manage under the Commonhold and Leasehold Reform Act 2002 is so badly drafted. The problem is acute, as the number of FTT and Upper Tribunal appeals evidence. RTM has proven popular. However, there are too many bear traps and uncertainties for all those involved in the process.

27. In particular:

a) We see no reason why dispensation for defects in notices should not be built into the regime. Presently, landlords and tenants are embroiled in technical disputes due to the uncompromising statutory language.
b) The FTT must have the jurisdiction to determine the extent of the RTM, that is, to define the extent of the land over which the RTM is to be exercised.
c) The *Gala Unity* problem of shared appurtenant property needs to be cleared up. The position following the Court of Appeal decision is unworkable in the extreme,
d) Consideration should be given to allowing, expressly, multi-block RTMs for ease of management (with appropriate geographical limitations).

e) Statute should provide expressly for the effect of an RTM on existing third-party contracts. Presently, that is the subject matter of extreme doubt, and arguments that they are frustrated are unconvincing. They should be expressly overridden, or the RTM company should have the right to elect to continue them or terminate them on notice.

f) It should be made clear that the person entitled to service charges pre-RTM is entitled, post-RTM, to ask for a determination of reasonableness and to recover outstanding charges, and to use any applicable costs clause under the Lease.

g) The scheme for transferring covenants should be reconsidered. It is unclear, and means that often there is doubt as to when the original party pre-RTM remains "on the hook" and when it is the incoming RTM Company that assumes responsibility. Many issues arise in this context. For example it is unclear to what extent the RTM company can prevent a freeholder from taking steps which are not management but affect management, e.g. redevelopment.

Reform To The Law Of Mortgages[6]

28. What follows is limited to mortgages of real property. We have sought to identify (a) areas where a more wholesale reform and/or restatement of the law is desirable, and (b) more limited areas where, in practice, difficulty is encountered.

29. The law of mortgages remains a complex area, often not fully understood by consumers and their advisers.

30. It is our view that there is merit in at least a clearer re-statement of

a) The fundamental nature of the mortgage/charge, and of the relationship between various forms of securities and the rights and obligations under each kind; and

b) The protection of consumers.

31. We do not propose to address mortgage matters principally falling within the purview of the Land Registration Act 2002, such as tacking and priorities.[7] We are also conscious that some

[6] Oliver Radley-Gardner

[7] On priorities, the only issue that we find somewhat puzzling is that priorities can be changed by consent without notifying the mortgagor of that fact, doubtless something that a residential owner would find a little surprising.

doctrines, such as subrogation but also some of the doctrines considered below, go beyond the law of mortgages, and it might be a mistake to consider them, and reform them, solely within that context.

Purely Regulatory Matters

32. We do not feel qualified to comment on purely regulatory matters, which appear to us to be matters that require a proper investigation into the market which we are not able to undertake. Furthermore, aspects of market regulation (such as the scope of mortgage-related "regulated activities" under Financial Services and Markets Act 2000) are influenced by European law, meaning that (a) the scope for reform may be limited due to the historic need to implement such provisions, and (b) query what the effect of Brexit is on the reform or further implementation of European norms.

33. We do think, however, that we can pick up on two points. First, the "regulated activity" test and constantly shifting consumer credit legislation, and secondly, the apparent disconnect between regulatory and pre-action requirements for mortgagees and the treatment of such issues in Court.

34. First, we do consider that one aspect of the test to establish whether the lending in question is a regulated activity, namely under the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, reg. 61(3)(a). This defines a regulated mortgage contract by reference to conditions including (iii), which states that a mortgage of land is caught if

(iii) at least 40% of that land is used, or is intended to be used—
(aa) in the case of credit provided to an individual, as or in connection with a dwelling; or
(bb) in the case of credit provided to a trustee which is not an individual, as or in connection with a dwelling by an individual who is a beneficiary of the trust, or by a related person;

35. This test is difficult to apply in practice, because in a number of cases concerning rural land, a dwelling will often have land with it (such as a paddock) which may or may not be used in connection with a dwelling. The frequency of such a situation means that it is often uncertain whether a proposed transaction is caught. See by way of illustration *Dickinson & Anor v UK Acorn Finance Ltd* [2015] EWCA Civ 1194. Indeed, it appears to us that the relationship between

regulated agreements and those caught by consumer credit legislation could be clarified, and, perhaps, it could be ensured that the rules are not constantly changing, as this gives rise to great uncertainty amongst borrowers and lenders alike.

36. Secondly, there is in addition a problem with the perception of how regulation, in particular expected good practice by mortgagees, should impact upon court proceedings. Mortgagors in litigation expect to be able to argue that mortgagees cannot take possession if they have not, for example, investigated possible repayment options, and the other issues that are governed by protocol. There may be an ongoing but unresolved complaint to the Ombudsman. As matters stand, those sorts of issues do not tend to influence the Court in making possession orders. It may be that they should not. However, mortgagors are currently receiving conflicting signals when they defend possession proceedings, whereby, for example, pre-action protocols and the regulatory overlay appear to say one thing, and the Courts appears to do something else. This conflict generates false hope and uncertainty.

37. Beyond the above, we have no comments on this important policy and industry-driven aspect of mortgages, which doubtless various stakeholders in the mortgage sector will address the Law Commission on.

Fundamentals of Mortgages

38. We consider that the law of mortgages is out of date, as it operates in a manner which would be surprising to many members of the public. We also consider that the fundamental rules of mortgages are unnecessarily obscure. For that reason it appears to us that there is real scope of a restatement of the law of mortgages, combined with reforms of its most egregious aspects.

39. *Harmonising Securities*: We note that Law Com 204 (1991), Transfer of Land – Land Mortgages, already made recommendations along these lines, which were, unfortunately, not taken up. It appears to us that there is a strong case for simply having a unitary form of land security, in the form of a charge, without retaining many of the surprising and unusual features of the mortgage in its fullest sense. The charge is of course the only method permissible for creating a mortgage of registered title after the Land Registration Act 2002, though the effects of a legal mortgage by conveyance have been replicated (C. Harpum *et al*, Megarry and Wade's Law of Real Property, paragraph 24-025 and following and 24-034). We consider that this carrying over of

those effects is something that needs to be looked at afresh. We can see that different policy considerations might apply in commercial and residential contexts, but that line is notoriously difficult to draw in practice. There might be a case, therefore, for a single, unitary form of security.

40. *Protection of Mortgagee*: We consider that the arcane rules of clogs and fetters, now infrequently encountered though still occasionally seen, are outmoded and ill-defined. It appears to us that the concerns which those rules seek to address – unfair advantages, economic duress and undue influence and other manifestations of unequal bargaining power – are either dealt with specifically by statute in the consumer sphere, or are regulated by more modern doctrines of contract law. We cannot see that the continued existence of the rules is justified in a modern, commercial world.

41. *Possession*: We can see no justification for an immediate right to possession when a mortgage is entered into. Although cases like *Ropaigealach v Barclays Bank plc* [2000] QB 263 are rare, they are in principle still possible and ought not to be. If possession is a remedy of last resort, which appears to be the philosophy behind and the effect of the recent procedural impediments relating to residential mortgage possession proceedings, then it seems to us appropriate that the logic of that is carried through into the substantive law, such that possession is no longer a right, but a remedy that can be invoked in response to breach of obligations.

42. *Foreclosure*: This is hardly ever encountered in practice. We question whether this remedy is still required. If it is to be retained, then the procedure for obtaining foreclosure is in dire need of modernising and streamlining for the rare occasions when it is used.

43. *Receivers*: Mortgagor-appointed receivers are frequently encountered in practice, and will often bring possession proceedings to evict mortgagors, the licensees and tenants. There still appears to be some doubt as to whether those powers include the power to go into possession. In fact, it seems to us that the default powers of a receiver in general to give statutory notices, bring possession proceedings, and so on could do with review and then codification.

44. *Principles*: it appears to us that a codification of the law of securities over land could usefully contain a statement as to the rules relating to marshalling, exoneration and other, very useful, doctrines which are presently buried away in the cases and seem to be frequently overlooked

as a result. It appears to us that there have been a number of useful statements of those principles that would make it easy to set out the general rules in one place.

Residential Mortgages

45. We regard the law in relation to suspension of possession, section 36 of the Administration of Justice Act 1970 and section 8 of the 1973 Act to require consolidation into one place, and for the provisions to be modernised in terms of their language. Those are important sections which litigants in person often come into contact with, and it is unsatisfactory that they are obscure in terminology, not easy to locate, and hard to understand and apply.

46. It is also problematic that the AJAs do not apply either to a mortgagee taking possession of empty property without possession proceedings, or to claims for possession by receivers. This is a lacuna in the regime. Both of these possible routes to possession appear to be more commonly used in the residential sector because of the increase in buy-to-let ownership. We consider that possession of empty residential properties without a possession claim and claims for possession by receivers perhaps ought to be brought within the AJAs (cf. *Horsham Properties v Clark* [2008] EWHC 2327 (Ch). This would not be difficult to legislate for, and for present purposes we cannot immediately see why something that is not available "through the front door" should be available "through the back".

47. By the same token, it may also be time to revisit the law relating to suspensions. The current law permits too many applications to be made by mortgagors. Whilst the Court can be expected to case-manage such applications, in reality there is little that can be done to shut out repeated applications, at vast expense to litigants and to the Court service.

48. The role of costs in mortgages, at least in the residential sector, could fruitfully be considered anew. It is common for mortgagees to add the costs to the mortgage debt. Most mortgagors, especially if without legal representation, will not seek an account of those costs when the property is sold. If they do, that involves expensive and time consuming litigation. It should be made clearer that the costs of the litigation are to be dealt with by the court, whether they are recovered as litigation costs, or as contractual costs, and via summary and/or detailed assessment in the usual way, without the need for separate proceedings. The court could, for example, stand over costs until sale, with a right to the mortgagor to apply for detailed

assessment within a fixed timeframe from sale, and standard directions for resolution of the same.

Bills of Exchange Act 1882[8]

49. You could simply point to the date and leave it at that!

50. Even though they are falling out of use, negotiable bills of exchange do still have some utility and the legislation is simply not fit for the 21st Century. It is cumbersome; it is technical; it has anachronistic language and it is based on commercial relationships and realities of a bygone era. It has been suggested that we abolish it. This may go too far, but it perhaps requires consideration. What might be preferable would be to update the legislation – to simplify the provisions on negotiation and holders (do we need mere holders, holders for value and holders in due course?), and to make it easier to have fully electronic bills. It is also possible to replicate much of the function of a bill of exchange contractually with a series of electronic promises to pay. However, the statutory protection to holders in due course or bona fide purchasers would be impossible. The question then becomes whether that matters, or whether something similar to BOLERO but for bills of exchange would be commercially viable. The Law Commission commented in 2001 that they were unaware of demand for fully negotiable electronic bills of exchange, but that was 15 years ago and a lot has happened since then.

Reforms to the law of Mistake

51. In *Pitt v Holt; Futter v Futter* [2013] 2 AC 108 the Supreme Court re-stated the test for equitable mistake and as to whether and when the court will set aside the exercise by a fiduciary of their powers. The clarification of the law of equitable mistake has largely been welcomed, leading to greater certainty and fairness as to when transactions will be set aside. However, the restriction upon the court's ability to set aside the mistakes of fiduciaries has not been so well received.

52. We are concerned about the following aspects of the current law:

    a) There is material unfairness in the existing test, particularly in requiring fiduciaries to

[8] Professor Duncan Sheehan, University of Leeds

have been acting in breach of duty for the court to intervene. There are no good policy reasons for such a restriction.

b) The Supreme Court's decision gives rise to considerable uncertainty as to certain aspects of the relevant test, such as whether it is necessary to show that a trustee 'would' or 'might' have acted differently in order to invoke the Court's jurisdiction.

c) Arising from the points set out above, both Jersey and Bermuda have introduced legislation to, in effect, reverse the SC decision. We are concerned that advances in other common law jurisdictions should not leave the law of England and Wales behind, particularly when certain aspects of the current law are in need of the clarification that legislation could provide.

53. There are also questions about the boundary between equitable and common law mistake as well as why the common law test of mistake is so difficult in comparison, and whether public policy is a freesstanding ground for the refusal of relief, and if so, in what circumstances (see *Van Der Merwe v Goldman* [2016] EWHC 790). Again, these are issues that might benefit from clarification through legislation.