LEASE DRAFTING IN AN UNCERTAIN WORLD:

EFFECTS OF FLEXIBLE WORKING, AUTOMATION AND HOME WORKING

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City law firms – the investor's bread and butter

Large law firm requirements have long been staple fair for the City of London market, with the sector taking on 3.4m sq ft, or 7% of take-up in the City core last year, according to EGi research.

However, that appears to be changing, at least in the UK, as the legal sector responds to uncertainty and starts to catch up with workspace innovations already adopted by tech and accountancy firms.

Could the same be true for Hong Kong, where international law firms prefer to keep their offices in the core business district? The Colliers forecast for 2017 is positive:

> "We believe that Central and Admiralty rents are unlikely to show negative growth due mainly to current very low vacancy and continuing strong demand for prime office space from mainland Chinese tenants."

It would therefore appear not – but the trends in favour of greater automation, flexible working and home working are global, and it is difficult to think of a reason why Hong Kong should be proof against these trends. As private equity people like to say, we are looking at a contraction in the investable universe.

Are robots coming for your jobs?

The received thinking, in London at any rate, is that a significant proportion of the traditional professional office jobs will be automated with increasing rapidity over the medium term. This is already happening, with the legal profession at its forefront:

- Dentons has created a tech incubator, Nextlaw Labs, which runs various projects including a Brexit search engine that reviews contracts for provisions that could be hit by Britain's vote to leave the EU.
- Pinsent Masons has developed a tool called TermFrame, which guides lawyers through deals and points them towards the right legal precedents.
- Linklaters has signed a deal with an AI provider, RAVN Systems, for a document analysis program.

- Luminance, a system backed by a private equity firm, claims to be able to "read" hundreds of pages of complex transactional information a minute, identify risks and sort documents.

Research carried out by Deloitte in 2016[1] indicates that tech developments have already contributed to the loss of 31,000 administrative and secretarial jobs in the legal sector, and warns that another 114,000 jobs are likely to be automated over the next 20 years.[2]

According to an article on 19 March 2017 in the New York Times[3],

> "the law firm partner of the future will be the leader of a team, and more than one of the players will be a machine".

In the same article, there is a profile of the work of James Yoon, a partner at Wilson Sonsini Goodrich & Rosati. Mr. Yoon uses software tools like Lex Machina and Ravel Law to guide litigation strategy in his patent cases. These programs pore through court decisions and filing data to make profiles and predictions about judges and lawyers. His comment:

> "the trouble is that technology makes more and more work routine."

Mr Yoon recalls 1999 as the peak of the old way of lawyering. A big patent case then, he said, might have needed the labour of three partners, five associates and four paralegals. Today, a comparable case would take one partner, two associates and one paralegal.

The article also mentions the experience of a Luis Salazar, a partner in a Miami firm, who began using an AI programme in course of development by Ross Intelligence. Type in a legal question and Ross replies a day later with a few paragraphs summarising the answer and a two-page explanatory memo. The results, said Mr Salazar, are indistinguishable from a memo written by a lawyer.

> "That blew me away. It's kind of scary. If it gets better, a lot of people could lose their jobs."

Home-working

Add to this relentless march of automation the growing practice of home-working.

In their report "Workplace 2020 – a study of the future of work"[4], Google commence by saying:

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[1] 'Developing legal talent. Stepping into the future law firm' – March 2016

[2] To see the likelihood of your job being automated in the next two decades, search your job title at http://www.bbc.co.uk/news/technology-34066941.

[3] https://www.nytimes.com/2017/03/19/technology/lawyers-artificial-intelligence.html?_r=1.

[4] https://gsuite.google.com/learn-more/workplace-2020.html.

> "It is largely agreed that the rise of the new generation of connected workers, empowered by collaborative and mobile solutions, will radically alter the shape of the future workforce and workplace."

If you can penetrate the language ("digital natives"; "mission-critical to survival"; "legacy baggage"; "customer-centricity aspirations"; "on-boarding"), the report makes for instructive reading. Two findings are particularly worth bearing in mind.

First, among professional and financial services organisations with a headcount of 6,000 or more, the facility for staff to work flexibly is expected to increase from 10% in 2015 to 66% in 2018, with lesser increases for smaller organisations. Overall,

> "Flexible working will be the defining characteristic of the future workplace, rising from 4% today to 32% of organisations polled by 2018."

Secondly, 43% of the same organisations polled were worried about their ability to lure the best talent, based upon their staff's changing needs in the workplace, which includes a new generation of connected workers, empowered by collaborative and mobile solutions.

Effect on the office market

It seems logical that, as the impacts of the new technology and more flexible working practices begin to bite, the demand for office space will diminish.

This is borne out in practice. Freshfields' just-announced pre-let of 255,000 sq ft at Brookfield Property Partners' 100 Bishopsgate in London will see it reduce its City take-up by 30%, shedding 116,000 sq ft in London. There are many other such examples of contraction in the investable universe.

Remedies

If our lay clients are to take all this seriously (which in London it appears they should, although the writing may not be on the wall yet in Hong Kong), then there are a number of ramifications not merely for portfolio diversification, but also for fit out and lease drafting, particularly in the areas of term length, break clauses, alienation provisions and rent review.

(a) Fit out

The modern office environment for millennials seems to require espresso bars and colourful work pods round every corner. Where Google and Apple lead today, it might reasonably be thought that lawyers will have to follow tomorrow.

(b) Term length

In my early days at the Bar, the standard form of institutional lease in the UK was of the order of 25 years. After only a few years in practice, term length had declined to 15

years, and it has now stabilised at about seven years, averaged across all sectors. The reason for this decline is largely down to tenant desire for flexibility.

Such flexibility comes at a cost, both in terms of security of tenure, and in transactional and legal fees, should the tenant wish to remain in occupation at the end of the term. The problem is worse in Hong Kong, where there is no statutory security of tenure. One possible solution that should suit both parties is for longer terms to be granted (thus going some way towards satisfying property owners), but with break clauses operable at periodic intervals (thus meeting tenants' demands for flexibility).

(c) Break clauses

But break clauses have a bad name, at least in the UK. Understandably, landlords' interests commonly favour keeping the tenant on the hook, and making it difficult to operate the break. The law is on the landlords' side: compliance with break clauses, for historical reasons, must be observed with minute precision; any infraction is fatal. As Lloyd LJ commented in Legal & General Assurance Company Ltd v Expeditors International (UK) Ltd [2007] 2 P&CR 10:

> "It is common ground that, in general, conditions attached to a break clause, as with any other option provision, must be strictly complied with, so that even a day's delay in giving vacant possession or a shortfall in the payment of rent of a few pounds would be fatal."

The usual expedients employed by landlords to frustrate the operation of break clauses are as follows:

(i) convoluted notice service requirements (with distinctions to be made between service at the registered office; at the last known address; only by post, etc);

(ii) conditions precedent, typically consisting of a requirement that all rent be paid and/or covenants be complied with. In the case of payment of rent, the most careful attention is needed, first to the terms of the redendum, to ascertain whether (for example) interest is reserved as rent; and secondly as to whether all rents have in fact been paid. In the case of compliance with covenants, a far-reaching enquiry will be necessary, not merely into the condition covenants (repair, redecoration and reinstatement), but also those requiring compliance with statute. In practice, a condition precedent requiring absolute compliance with covenants is virtually impossible to satisfy.

A well-advised tenant will refuse a break clause altogether as an alternative to a shorter term. Even if the break clause is not hedged about with conditions precedent, and the

notice provisions are simple, break clause operation seems to attract more mishaps and pratfalls than any other area of the law.

The well-advised landlord will seek to lure its tenant with a vanilla break clause, in exchange for a longer term. Although it may not have the certainty of locking in the tenant for the full term, its preparedness to entertain a straightforward break clause should stand it in good stead in relationship terms.

(d) Alienation provisions

Philip Pearce, executive director in Savills' central London office team, said on 23 February 2017, in relation to the Freshfields news:

> "I think if you're doing a pre-let anywhere at the moment, then with such high levels of uncertainty then absolutely it would be prudent to ask for some degree of flexibility in the form of being able to put space back or add more."

This sentiment is at odds with the desire of institutional landlords to have clean lease terms, with no movement over the course of the term (other than increases in rent). However, if the alternative is no pre-letting at all, or lettings at lower rent to reflect the lack of flexibility, then landlords may see the sense in packages that allow for accommodation to be added to or subtracted from (by way of options to extend or surrender), or dealt with in other ways (subletting, licensing and co-working).

This form of flexibility is already built in to the Hong Kong letting market. Here, it is the UK that should catch up with its eastern counterpart.

(e) Rent review

The standard rent review formula that has evolved over the decades since its emergence in the 1960s does not attempt to deal with some of these problems – and in particular more flexible alienation provisions. A well drafted clause will accommodate such matters. At its simplest, a rent review formula in the case of a lease containing options to extend or surrender will building a mechanism allowing for apportionment of the rent payable in the event of exercise of the option.

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