BPF
BRITISH PROPERTY FEDERATION

PLC Property Law

Commercial Property Standard Enquiries

GN/CPSE.2 (version 2.0)

Guidance notes on CPSE.2 Supplemental pre-contract enquiries for commercial property subject to tenancies

The CPSE.2 enquiries should be raised in addition to the CPSE.1 enquiries where the Property is subject to commercial tenancies (whether or not the Property itself is freehold or leasehold). CPSE.2 does not deal with any residential tenancies to which the Property may be subject. The Seller is the current landlord in relation to the tenancies to which the Property is subject.

These guidance notes:

- Enable the enquiries to be presented in a concise form without the need for illustrative examples.
- Are intended to help the legal advisers, the Buyer and the Seller to understand why individual enquiries are raised, how the enquiry should be answered and what may need to be done depending on the nature of the reply.

The Buyer may wish to keep a set of the guidance notes with the Seller's replies to the enquiries to assist the Buyer in understanding and using the information in the replies both during the period of the Buyer's ownership and later on a subsequent sale of the Property.

The enquiries stand on their own and do not depend on the guidance notes for interpretation.

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GUIDANCE NOTES

SECTION 1

UNLET PARTS OF THE PROPERTY

The information requested in the Section 1 enquiries must be given in respect of each part of the Property that is not let under a tenancy. The definition of 'tenancy' includes a headlease, an underlease, a licence and an agreement for either a lease or licence. An area that is occupied under a licence is still a Let Unit for the purposes of these enquiries. It is for the Seller and its advisers to decide how to present the information requested but, for ease of understanding, the information may best be presented in the form of a table.

VOIDS

Voids are those areas of the Property which the landlord intends to let but which are currently unlet. Voids may have a significant impact on the income which is able to be derived from the Property. The Buyer will want to know why there is no current letting (for example because there was a long term plan to get vacant possession in order to redevelop, or because the area became vacant and no effort has yet been made to market it, pending the proposed sale to the Buyer). The Buyer may wish to start marketing the vacant area and will want to know what has been done to market it and whether there is anyone who might be interested in taking a tenancy of it.

COMMON PARTS

Areas of the Property may be unlet because they are designated as common parts to be used by the landlord and the occupiers of the Property in accordance with the individual occupational lease terms. Common parts typically include stairs, lobbies, entrance halls and access roads but they are determined by the physical layout of the Property, the number of occupancies, and the needs of the occupiers.

RETAINED PARTS

Retained parts of the Property will be those parts which are neither designed nor intended to be separately let, nor treated as common parts, but are retained by the landlord. These parts may be used by the Seller for a particular purpose (as office or storage space, for example) and the Buyer will need to establish whether the cost of insuring and maintaining these retained areas will be met by the tenants of Let Units or by the landlord.

SECTION 2

CURRENT TENANCIES

The information requested in the Section 2 enquiries must be given in respect of every tenancy to which the Property is subject (other than any lease which the Seller is to transfer to the Buyer). The definition of 'tenancy' includes a lease, an underlease, a licence and an agreement for either a lease or licence. Where the Property is divided into separate units, and there is more than one tenancy relating to any unit, then the information requested must be supplied in relation to each such tenancy (as defined in form CPSE.2). It is for the Seller and its advisers to decide how to present the information requested but, for ease of understanding, the information may best be presented in the form of a table.

TENANCIES TO WHICH THE PROPERTY IS SUBJECT

This enquiry is about current tenancies (as defined) and the enquiries need to be answered in respect of each current tenancy.

Enquiry 4.1 The occupier will not necessarily be, or only be, the person who is the Seller's immediate tenant of the Let Unit. Occupation may be by a company within the same group as the company that is the immediate tenant, or by an unassociated body. Occupation may also be by virtue of a licence, a sublease, or by trespassers.

Enquiry 4.3 In accordance with the definition, 'Tenancy Documents' may include side letters. These may vary the terms of a lease by, for example, waiving the landlord's entitlement to the full amount of rent due for a period, by imposing a cap on the amount of service charge which is recoverable or by authorising the use of additional car parking facilities.

Enquiry 4.4 Even a failure to complain that rent is regularly paid late may constitute an informal agreement which could bind the Buyer: *Hazel v Akhtar* [2002] 07 EG 124.

Enquiry 4.5 The Buyer may wish to negotiate a term in the contract to require the Seller to take into consideration the Buyer's wishes as to how an application by an occupational tenant should be dealt with.

RENT AND RENT REVIEW

If the Property is subject to leases, the Buyer will probably be interested in it as an investment. The Buyer will therefore be concerned to know everything about the rental income, including the extent to which rent has not been recovered, whether rent will or can be recovered and at what cost, and whether the level of income will change because of rent reviews or concessions.

Enquiry 5.2 Although the existence of any rent suspension clauses should be apparent from the tenancy documents, the Seller should include here details of any rent suspension currently in effect.

Enquiry 5.4 There is a presumption that, even where a rent review clause stipulates that certain parts of the rent review procedure must be completed by a specified time, time is not 'of the essence' and therefore a failure to observe those time limits does not have any consequence. The following are exceptions to this rule and illustrate where time will be of the essence and the time limits will be binding on the parties:

- Where the rent review clause expressly provides that time is to be of the essence;
- In certain circumstances where the clause states the consequence of not complying with the time stipulation;
- In certain circumstances where a party serves a notice making time of the essence;
- Where the clause structure demonstrates an intention that time should be of the essence; and
- Where the relationship between the rent review clause and another provision in the lease (such as a break clause) by implication makes time of the essence.

The Buyer will need to review the rent review terms in the light of what has happened in practice.

Enquiry 5.6 The general rule is that where premises have been improved, the improvements form part of the premises and will be valued for the purposes of calculating the rent ('rentalised') unless they are to be 'disregarded'. Whether or not improvements are to be rentalised will depend on the wording of the lease. Generally the rent review clause will provide that in calculating the rent on a review, an improvement is to be disregarded where it was carried out by the tenant, and at the tenant's expense, with the landlord's consent (where required) but not because the landlord required it to be carried out.

ALTERATION AND REDECORATION

Enquiry 6.1 The particular dates on which the Let Units were last redecorated will not necessarily correspond with the required dates for redecoration under the tenancies. The Buyer will wish to know the actual dates to decide whether any enforcement action is needed for breach of covenants to redecorate and to assess whether any breach can arguably be said to have been waived.

Enquiries 6.2 and 6.3 Part I of the Landlord and Tenant Act 1927 (as amended by Part III of the Landlord and Tenant Act 1954) lays down a scheme under which, subject to certain conditions being met, a business tenant may, on termination of its tenancy, be entitled to compensation for improvements which it has carried out to its premises.

Qualifying improvements are those which 'add to the letting value of the holding' and may include the erection of the building itself. A tenant must serve notice on the landlord before starting work on any improvement that is to qualify under the 1927 Act, although there is no prescribed form for the notice. In certain cases the tenant's letter requesting consent for works may be treated as a notice. On receiving a notice, the landlord may either object that the work proposed is not an improvement, or may opt to carry out the work itself, charging a reasonable increase in rent (determined by the court if the parties cannot agree it). If the landlord carries out the work itself, the tenant cannot make a claim for compensation.

The Buyer's reason for making this enquiry is to establish whether, at the end of the tenancy, the tenant can claim any compensation, and, if so, how much.

Compensation for improvements under the 1927 Act should not be confused with compensation for non-renewal of a business tenancy under section 37 of the 1954 Act, nor with the requirement that certain improvements should be disregarded in assessing the rent payable on the renewal of the tenancy under the 1954 Act, which is dealt with in enquiry 12.2.

ENFORCEABILITY OF TENANT'S COVENANTS

Enquiry 7.1 The Buyer needs to establish whether the lease constitutes a 'new tenancy' as defined in section 1 of the 1995 Act. This may not be apparent on the face of the tenancy document creating the lease. Different rules apply to the liability of parties following a sale of a lease depending on whether or not that lease constitutes a 'new tenancy'. If the lease is not 'new', the original tenant remains liable during the whole of its term, and all subsequent tenants are likely, through direct covenants with the landlord, to remain liable during the remainder of the term. If the lease is 'new', the basic rule is that only the current tenant will be liable under the lease. Once the tenant has assigned the lease, it and its guarantor, if any, cease to be liable. On an assignment of a 'new tenancy', the outgoing tenant may be asked or required by the landlord to enter into an 'authorised guarantee agreement'. This is a type of guarantee agreement permitted under the 1995 Act which effectively makes the outgoing tenant a guarantor of the incoming tenant until that incoming tenant itself assigns the lease. The Buyer ought to be aware of any authorised guarantee agreements because they should be

included with the tenancy documents; in practice, they are often incorporated within a licence to assign.

Enquiry 7.2 This enquiry applies only to 'new tenancies' under the 1995 Act. Section 11 of the 1995 Act defines 'excluded assignment'. The most common reason for an assignment being excluded is because it has taken place without the landlord's prior consent, where that consent ought to have been obtained. This commonly happens where the assignment is taking place as part of a company asset sale, which for commercial reasons needs to be kept confidential, making it undesirable to leak the proposed deal to the public through an application to the landlord for consent to assign. On a strict reading of the 1995 Act, a subsequent grant of consent will not rectify the situation and the assignment will remain an excluded assignment until the next assignment which is not itself an excluded assignment. The other reason an assignment may be excluded is because the assignment has taken place 'by operation of law' as, for example, where on a privatisation, legislation has operated to transfer property from one body to another.

The significance of an assignment being an excluded assignment is that the outgoing tenant remains liable under the lease together with the new tenant. This information will be relevant to the Buyer because if the assignment of the lease to the current tenant was an 'excluded assignment', the Buyer will be able to enforce the tenant covenants against both the current and the former tenant.

Enquiry 7.3 This enquiry is relevant to all leases, regardless of whether or not they constitute 'new tenancies' under the 1995 Act. Under section 17 of the 1995 Act, where a tenant has failed to pay sums due under a lease and a former tenant or guarantor remains liable for that default, the landlord can only recover these sums from the former tenant or its guarantor if it has served notice of its intention to do so. The notice must be in the form prescribed by section 17 and must be served on every former tenant and guarantor against whom the landlord wishes to recover. The notice must be served within six months after the sums first became due.

This element of the 1995 Act is more important for 'old' leases, i.e. those granted before 1 January, 1996 because generally under new tenancies a former tenant will have no continuing liability. The exceptions are liability under any authorised guarantee agreement as mentioned at 7.1 and cases where the assignment to the defaulting current tenant is an 'excluded assignment' (see above).

Enquiry 7.3(c) is made to alert the Buyer to the need to serve section 17 notices following completion of the Transaction and also to warn the Buyer of potential claims for overriding leases (see enquiry 7.4 below).

Enquiry 7.4 If a former tenant or its guarantor has been served with a section 17 notice of the landlord's intention to claim unpaid sums due under a tenancy, and pays in full the amount claimed, that former tenant or guarantor is entitled to claim an overriding lease under section 19 of the 1995 Act. An overriding lease is a lease of the premises, granted by the landlord to the former tenant or guarantor and which slots in above the lease to the defaulting current tenant, so that the claimant becomes both the landlord's new immediate tenant and the landlord of the defaulting tenant. The form of the overriding lease is the same as the lease which it overrides, i.e. the lease between the landlord and the defaulting tenant. The advantage of taking an overriding lease for the former tenant or guarantor is that it gains an interest in the premises and a degree of control over the defaulting tenant. It can sue the defaulting tenant and, as landlord can bring forfeiture proceedings against the defaulting

tenant if there is a further breach of covenant. The advantage for the landlord is that it has as its immediate tenant someone who has demonstrated an ability to pay the rent. The disadvantage is that the landlord may end up with someone whom it would not have chosen to be tenant, perhaps because the former tenant had been difficult or unreliable as a tenant in the past.

The Buyer will want to know whether there are any potential claims for overriding leases. A claim for an overriding lease can be made at any time within 12 months after full payment under a section 17 notice has been made.

OUTSTANDING OBLIGATIONS AND VARIATIONS

Enquiry 8.1 Under the 1995 Act an assignee (whether of the lease or the reversion) becomes liable under the covenants unless they are personal to the assignor. Covenants for these purposes may include obligations contained in any agreement for lease. The Buyer will need to know whether there are any obligations in an agreement for lease which remain unfulfilled and for which he may become liable on completion of the Transaction. These might include obligations to build, alter, repair or fit out any Let Unit. The Buyer may need to reflect the cost in the price for the Transaction or to negotiate indemnities. The Seller should beware that, according to the Court of Appeal in *BHP Petroleum Great Britain Ltd v Chesterfield Properties Ltd* [2001] 3 WLR 227, personal covenants are not released by the mechanisms of the 1995 Act and it may therefore need to consider whether to reserve appropriate rights to comply with any continuing personal obligations.

Enquiry 8.2 The Buyer needs to know how any lease of any Let Unit may have been varied, when the variation was made, and who was party to it. Variations affecting the length of term of a lease or the extent of the premises demised by the lease may constitute a surrender of the existing lease and the grant of a new lease. If such a variation is made to a pre-1996 lease, the regrant will be treated as a grant of a new lease under the 1995 Act, so that the variation will have effectively converted an old lease to a 'new tenancy', to which the 1995 Act liability regime will apply.

Even if the variation does not constitute a surrender of the lease, it may still release a guarantor from all further liability unless either the guarantor has consented to it or there are provisions in the guarantee agreement to permit such variations. The guarantor in question could be the guarantor of a former tenant or of the current tenant, or a former tenant who has given a guarantee in the form of an AGA. Release under this rule of law cannot apply to the original tenant or a former tenant under an 'old tenancy', as neither are in the position of a guarantor. However, their liability may be capped (see the following paragraph).

Where the variation has not released the guarantor, the guarantor's liability, and that of former tenants, may still have been limited. Where the lease obligations have been made more onerous by a variation of terms, a former tenant (which includes a former tenant who has provided an AGA) or the guarantor of a former tenant is not liable insofar as liability has been increased by the variation. This is the effect of the Court of Appeal's decision in *Friends Provident Life Office v British Railways Board* [1995] 1 All ER 336 but, in addition, for variations on or after 1 January, 1996, section 18 of the 1995 Act has the same effect. It is not clear, however, whether section 18 applies if the former tenant or the guarantor of the former tenant was a party to the variation (as a result of the operation of the anti-avoidance provisions in section 25 of the 1995 Act). The protection afforded by section 18 does not apply to the current tenant's guarantor.

RENT DEPOSITS, GUARANTEES AND BONDS

This enquiry is concerned with rent deposits, bank bonds and guarantee or surety agreements. The extent or duration of the liability of any guarantor will depend on whether the lease is one to which the 1995 Act applies (see above).

SERVICE CHARGES AND MANAGEMENT

Where appropriate, enquiry 10 should be answered in relation to the Property as a whole, rather than the individual tenancies to which it is subject.

It is important that the Buyer is fully informed regarding service charges so that it can assess the likelihood of a service charge dispute, even if there is none at the time of the Seller's replies.

INSURANCE

Enquiry 11.2 If a tenant does something which gives rise to a claim on the landlord's insurance, then as it is the landlord rather than the tenant who is the insured, the insurance company may pursue its own claim against the tenant who caused the loss, to recover the amount of the insurance claim. This is known as the insurance company's right of subrogation. It is considered to be unfair to the tenant if at the same time the cost of the insurance premiums is paid by the tenant. A tenant will usually therefore try to negotiate that the insurance company waives its rights of subrogation.

TERMINATION OF TENANCIES

Enquiry 12.1 This is included as a reminder to the Seller to include in the package of tenancy documents all documents relating to the termination of a tenancy, including applications by the tenant to renew the tenancy under the Landlord and Tenant Act 1954.

Enquiry 12.2 When the tenant exercises its right to a renewal of its business tenancy under the 1954 Act, the amount of rent it can be required to pay must not include the value of any improvements which it has carried out to the Property at its expense (section 34(1)(c) of the 1954 Act).

Enquiry 12.3 Following the decision in *Esselte AB v Pearl Assurance Plc* [1997] 2 All ER 41, provided that a tenant vacates the premises before the expiry of the contractual term, there is no need for the tenant to serve the landlord with a section 27 notice to terminate the tenancy. As a result, the landlord does not know before the contractual expiry date whether the tenant intends to vacate the premises and if so, when. This puts the landlord in a difficult position as far as remarketing the premises is concerned. If the Seller has any indication of a tenant's intentions, this should be passed to the Buyer in the reply to this enquiry.

RESIDENTIAL

If the Property is subject to any residential use, the Buyer will need to raise additional enquiries.

DISPUTES, COMPLAINTS AND ENFORCEMENT

The Buyer will be concerned to know the nature of any breach and whether it has been waived by the continued demand or acceptance of rent. The Seller should include not only breaches of the tenant covenants under the tenancies but also any breaches of the landlord covenants for which the Seller is liable. The Buyer will want to know whether there are any continuing breaches of any landlord covenants, for which the Buyer may be liable on completion of the Transaction, and also in relation to any breaches, whether by landlord or tenant, what enforcement action has been taken, if any.