



## RESPONSE FORM

### PREPARATION OF THE NINTH PROGRAMME OF LAW REFORM

We hope that by using this form it will be easier for you to respond to the questions set out in the consultation paper. Respondents who wish to address only some of the questions may do so. The form reproduces the questions as set out in the paper and allows you to enter comments in a box after each one. At the end of the form, there is also space for any general comments you may have.

Please note that information about this consultation paper, including copies of responses, may be made available in terms of the Freedom of Information (Scotland) Act 2002. Any confidential response will be dealt with in accordance with the 2002 Act.

We may also (i) publish responses on our website (either in full or in some other way such as re-formatted or summarised); and (ii) attribute comments and publish a list of respondents' names.

In order to access any box for comments, press the shortcut key F11 and it will take you to the next box you wish to enter text into. If you are commenting on only one or two of the questions, continue using F11 until you arrive at the box you wish to access. To return to a previous box press Ctrl+Page Up or press Ctrl+Home to return to the beginning of the form.

Please save the completed response form to your own system as a Word document and send it as an email attachment to [info@scotlawcom.gsi.gov.uk](mailto:info@scotlawcom.gsi.gov.uk). Comments not on the response form may be submitted via said email address or by using the [general comments form](#) on our website. If you prefer you can send comments by post to the Scottish Law Commission, 140 Causewayside, Edinburgh EH9 1PR.

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# Questions

1. Do you have any suitable law reform projects to suggest?

## Comments on Question 1

Issues relating to the termination of commercial leases

2. Do you have any project to suggest that would be suitable for the law reform process in the Scottish Parliament; or, in relation to reserved matters, for the House of Lords procedure for Commission Bills?

## Comments on Question 2

«InsertTextHere»

3. If suggesting a new project:-

- (a) Please provide us with information about the issues with the law that you have identified:

**We attach a paper which provides information on all of the following issues which arise in connection with the termination of commercial leases**

- 1 **Does irritancy of the head lease terminate the sub-lease?**
- 2 **Does the sub-lease survive the voluntary surrender of the tenant's interest in the head lease?**
- 3 **Confusio – keeping the lease alive**
- 4 **Irritancy of leases - creditor protection**
- 5 **Service of notices to quit and irritancy notices**
- 6 **Termination of lease on the dissolution of a partnership**
- 7 **Application of the doctrine of rei interitus to commercial leases**

- (b) Please provide us with information about the impact this is having in practice:

Please see paper attached.

(c) Please provide us with information about the potential benefits of law reform:

Please see paper attached

**General Comments**

«InsertTextHere»

Thank you for taking the time to respond to this consultation paper. Your suggestions and comments are appreciated and will be taken into consideration when preparing our Ninth Programme of Law Reform.



Scottish Law Commission

9<sup>th</sup> Programme of Law Reform

Proposals for reform of Commercial Leases

**BRODIES** LLP

[www.brodies.com](http://www.brodies.com)

## **Proposals for reform of the law relating to the termination of commercial leases**

We are pleased to contribute to the Law Commission's consultation on proposals for law reform to be included in its Ninth Programme. Brodies is a large commercial law firm with around 100 lawyers working solely on property related matters. We deal with all types of properties from residential to rural to the highest end of the investment market. Our paper below highlights some of the issues which we have come across in practice and which we feel, in some cases, make Scottish commercial leases less attractive to landlords, tenants and funders.

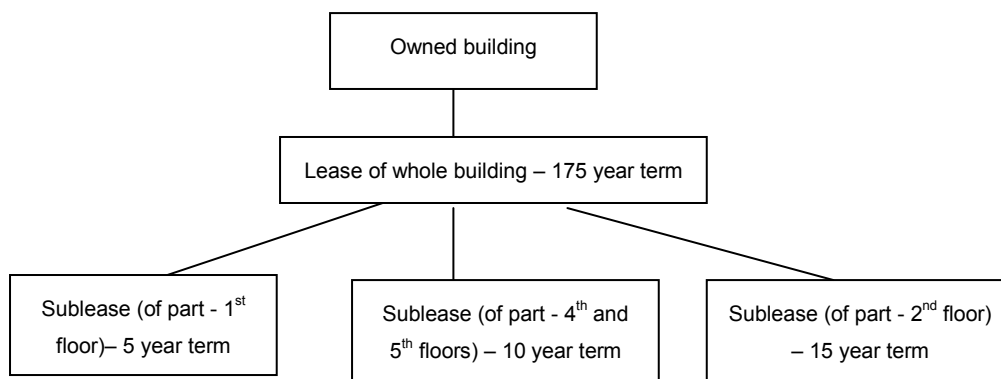
### **1 Does irritancy of the head lease terminate the sub-lease?**

#### **1.1 Background**

We deal with different types of lease structures involving head leases and sub-leases for different types of properties. One of the most common examples is found in shopping centre lease structures. We have acted in the acquisition, sale, and financing of several shopping centres over the past few years including Eastgate Shopping Centre in Inverness, Ayr Shopping Centre, Ocean Terminal, St Enoch Centre Glasgow and Bon Accord and St Nicholas Shopping Centres in Aberdeen. The majority of these centres are subject to a head lease (often a ground lease from a local authority) in favour of an investment fund. Below the head lease are the occupational leases between the investor and the occupational tenants (shops, kiosks etc).

We have also been involved in student accommodation transactions which involve a head lease to a developer/ investor and a sub-lease to the operating company. Below those leases would be the tenancy agreements with the student tenants.

Below is a sample structure. The sample is relatively straightforward compared to some. For example, there can be another lease between the 175 year lease of the whole building and the occupational sub-leases for rent sharing purposes. Whilst such structures can be quite complicated, in each case where there is a head lease and a sub-lease, the survival of the occupational sub-lease is dependent upon the superior lease or leases not being irritated.



## **1.2 Different types of head leases**

Investment lease structures develop in different ways. Many involve a local authority granting a ground lease to a developer/ investor. Some of these head leases will be bare leases with few obligations imposed on the head tenant. Others will contain development and repairing obligations. Those ground leases with very few obligations on the tenant will offer little, if any, opportunity for the head landlord to irritate the lease. The others which are full repairing and insuring leases will provide for the head landlord to irritate in the event of breach.

The ground leases will be for a long period of time (now a maximum of 175 years) for investment purposes. The ground, if not already developed, will be developed and the investor will then let the properties to occupiers. In the case of the FRI head lease, the tenant in the occupational lease (the sub-lease) is exposed to the danger of the irritancy of the head lease and collapse of their lease. Some, but not all sub-tenants will enter an Irritancy Protection Agreement with the head landlord, giving them the opportunity to enter a lease directly with the head landlord in the event that the head lease is irritated.

## **1.3 The effect of irritancy of the head lease on the sub-lease**

In practice, the generally accepted answer to the question of whether the sub-lease terminates on irritancy of the head lease is yes. If a superior lease is irritated by the head landlord, unless the sub-tenant has entered an agreement directly with the head landlord, the sub-lease will fall. In order to avoid this situation, some sub-tenants will seek to enter an Irritancy Protection Agreement directly with the landlord. In the event of termination of the superior lease, a direct relationship between the sub-tenant and the landlord will begin.

Irritancy of the head lease does not of course always result in the fall of the sub-lease. If the irritated lease was interposed between the sub-lease and the head lease, the sub-lease will survive in terms of Section 17 of the Land Tenure Reform (Scotland) Act 1974.

Whilst it may be considered important to protect sub-tenants from the effects of irritancy of the head lease, the protection, if any, must be balanced against the wishes of the head landlord. In some situations, a head landlord may have refused consent to the assignation of the head lease and instead consented to the sub-lease. They most likely will do so where they wish to have a direct relationship with the head tenant for reasons relating to the covenant of the proposed sub-tenant. If the head lease were to be irritated, the head landlord may not wish to enter a lease with the sub-tenant. It must also be borne in mind that the breaches of the head lease which trigger the irritancy proceedings may be down to breaches on the part of the sub-tenant, eg failure to pay rent or keep the premises in repair. If sub-tenants are to be given unfettered protection against irritancy of the head lease, a head landlord would have a tenant not necessarily of his choosing or to his liking.

In contrast, in a situation where the tenant has voluntarily renounced their interest in the head lease, such a renunciation, unless provided for in the lease itself, would have required the consent of the head landlord. The head landlord in that situation has the choice of whether to accept the renunciation in the knowledge that the sub-lease would survive and the sub-tenant would become the tenant.

## 2 Does the sub-lease survive the voluntary surrender of the tenant's interest in the head lease?

We have been asked many times to confirm that a sub-lease will survive in the event of the voluntary surrender of tenant's interest in the head lease. We have responded yes to such a question using an opinion dating back to 1982 from The Conveyancing Opinions of JM Halliday as authority for our position (copy attached). Our position on this point has largely been accepted but we would much prefer that the position was clarified in law and reflected that opined by Halliday to lend security to the sub-tenants involved.



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## 3 Confusio – keeping the lease alive

The other point covered in the same opinion by Halliday is whether the purchase of the heritable interest by the head tenant results in the extinction of the head lease. We have come across such a situation in practice many times and in some of these situations for funding and other purposes, the head tenant wishes to keep the head lease alive and does not want confusio to operate. For example, the sub-lease may rely on the head lease for importing many of the obligations incumbent on the sub-tenant. There may be a security granted over the head lease which the new former head tenant wishes to remain in place. The former head tenant may want to sell the interest of head tenant for investment / management purposes.

When submitting the application for registration of the heritable interest purchased by the head tenant, Registers of Scotland have proceeded on the basis that the presumption of confusio can be rebutted. Whilst this is helpful in situations where the parties want to keep the head lease alive, it is not satisfactory as some case law muddies the waters on this point. Below is an extract from the Legal Manual of Registers of Scotland dealing with this point:

### Legal Manual of Registers of Scotland

#### 19.15.4 *Confusio*

This is a rule of general application to obligations in Scots Law. Where the same person in the same legal capacity becomes both the debtor and the creditor in such an obligation, that obligation is said to be extinguished *confusione*. In relation to leasehold property, where the same person in the same legal capacity becomes both landlord and tenant in the same lease (e.g. by succession or by disposition or assignation as appropriate), there is now a generally accepted presumption that *confusio* operates to extinguish the lease, unless the proprietor acts in such a way as to rebut that presumption. It is settled that a lessee who obtains a disposition of his leasehold need only look thereafter to his title as owner for his rights and obligations.

Notwithstanding the foregoing, agents differ in their ways of dealing with property where their client has acquired both leasehold and heritable titles. Many continue to dispose the subjects and assign the lease, while others dispose the subjects omitting the assignation of the lease and not excepting the lease from warrandice.

The intention of the agents will normally be evident from the application for registration, but it will on occasion be necessary to obtain written confirmation from them as to the intended position. Where doubt exists, the case should be referred to a senior caseworker for consideration.

Where it is considered that a lease has been extinguished *confusione* but that third party rights exist in relation to some of the conditions of let, a burdens entry should be prepared which shows the subsisting conditions (see 3rd example in section [19.19\(Leasehold Titles - Burdens Section Entries - Styles of Preambles\)](#)).

In a similar fashion to Section 19 of the Title Conditions (Scotland ) Act 2003 which provides that a real burden is not extinguished only by reason of the burdened and benefited properties being owned by the same person, we would suggest that it be confirmed in law that *confusio* does not automatically apply to extinguish a head lease. If the head tenant wishes the head lease to fall, he may voluntarily surrender the head tenant's interest.

#### **4 Irritancy of leases - creditor protection**

Another issue which we have found with the operation of irritancy in relation to leases is the lack of protection for creditors of tenants in long leases. Unlike in England, there are no rules of court which require any interested creditor to be notified of any application, such as an application by an insolvency practitioner.

As a matter of good practice, we will include provision in the irritancy clause for a creditor to be notified at the same time as the tenant of a breach by the tenant and threatened irritancy. If this notification does not take place, the only party who can take action against the landlord for this failure is the tenant. The creditor is denied the chance to defend any irritancy proceedings as the tenant or to cure any breaches and preserve the value of its security. This lack of compulsory notification leaves a creditor exposed to losing their security and makes Scottish leases less attractive for funding purposes.

Looking back at the Commission's Report on Irritancy in Leases of Land in 2003, we would support the recommendation that a copy of all forms of warnings, moratorium notices and notices of termination should be served on qualifying creditors. Qualifying creditors would be those whose security is recorded in the Sasines Register or the Land Register.



## **5 Service of notices to quit and irritancy notices**

The law relating to the service of notices to quit to bring leases to an end dates back to the Sheriff Courts (Scotland) Act 1907 and should be revisited and updated. McAllister in his text on Scottish Leases comments “Despite the uncertainties about its application, the provisions of the Sheriff Courts (Scotland) Act 1907 should be adhered to.” Below is a guidance note from our style notice to quit warning our solicitors to take care when serving notices that they have the correct amount of time required which illustrates how complicated matters can become.

*At common law, notice requires to be given at least 40 **clear** days before the stipulated expiry date of the Lease, **but** where the contractual removal date is Whitsunday or Martinmas (i.e. using those terms and not the dates 28 May and 28 November), notice must be given at least 40 days before the 15<sup>th</sup> and 11<sup>th</sup> of these months respectively (Section 4 of the Removal Terms (Scotland) Act 1886). If, in either case, the 28th falls on a Sunday, the removal date is postponed, in terms of the 1886 Act, until 12 noon on the 29th; in that event, the 29th of the relevant month and year should be specified in the notice at prompts -3 and -9.*

Notices to quit, if ineffective, can be very expensive for the party wishing to bring the lease to an end. We would suggest that the opportunity be seized to update and simplify the procedures for serving such notices under leases.

We would also ask the Commission to consider the rule that notice to quit for properties exceeding 2 acres should be served at least one year in advance. We would expect that such a provision was made for the purposes of rural properties and that today’s commercial properties of such a size were not considered. Since agricultural properties have their own legislation regulating the termination of tenancies, we would suggest that all other non-domestic properties, whatever their size, be subject to the same notice period.

We would also urge the Commission to review the rules on service of irritancy notices and to update the methods of service which will be acceptable. The current law on this matter is the Law Reform (Miscellaneous Provisions) (Scotland) Act 1985. The case of Kodak Processing Companies Limited v Shoredale Limited 2009 [CSIH] illustrated how the provisions of the 1985 Act are too restrictive and should be updated. In that case, there was a postal strike and so the party wishing to terminate the lease had the notice to terminate served by Sheriff’s Officers. In today’s terms, provided the address for service is correct, service by Sheriff Officers is a very effective way of giving parties notice. However, the Court had to follow the statutory provisions and rule that the service was ineffective.

## **6 Termination of lease on the dissolution of a partnership**

Another question which we come across is whether a lease survives the dissolution of a partnership and the distinction between leases to a “house” partnership and leases to a “normal” partnership.

It is generally understood that a lease will come to an end on the dissolution of a partnership. However, this general rule is subject to several qualifications. If the partnership is dissolved by the death of a partner or otherwise, the lease may continue if it is assignable. In the case of Inland Revenue v Graham’s Trustees 1971 SLT 46, it was held that the lease was an asset of the dissolved firm and that it would revive if it were

assigned to a new tenant. A lease will also survive if the lease was granted to the 'house'. However, it is not always easy to ascertain whether the lease was granted to the 'house'. One has to look at the intention of the parties and reference to successors and assignees of the partners.

Where a lease was not granted to the house and one partner dies, it is not clear whether the lease survives if the partnership agreement has provided that the partnership is to survive the death of a partner.

All of this is very unsatisfactory and could be made clear in legislation which stipulates when the lease will be terminated and when it will not. Landlords would clearly wish for the lease to remain in place and the former partners to remain liable for the lease obligations until a replacement tenant is found if the partnership is no longer trading. The partnership on the death of a partner, may also want to continue trading from the premises.

## **7 Application of the doctrine of *rei interitus* to commercial leases**

The doctrine of *rei interitus* will be excluded in the vast majority of commercial leases. However, it is not always excluded in ground leases. This is because it is thought that the subjects will never be destroyed and so the lease will not be frustrated. However, the failure to exclude *rei interitus* in some ground leases has caused issues because, at the time of grant of the supposed "ground lease", there have been buildings erected on the land. If these buildings are destroyed, it would be open to the head landlord to argue that the lease was frustrated and at an end. There is unlikely to be a provision in the ground lease calling for the buildings to be reinstated in the event of destruction. Such a provision will most likely exist in the occupational sub-leases below the head lease but the provision for reinstatement will be meaningless if the head lease is brought to an end and the occupational sub-leases with it.

In an ideal world, the doctrine of *rei interitus* would not apply to commercial leases. If this position cannot be reached, we would suggest that it be declared that an exclusion of *rei interitus* in the lowest lease in a chain would prevail over the lack of such an exclusion in a superior lease in the chain to the extent of the subjects let. If this position is confirmed, care would have to be taken when drafting any leases below the ground lease to ensure that *rei interitus* is excluded in the leases of all the properties covered by the ground lease so that leases of some properties did not fall while others survived. This may not be a great concern as it is standard practice to exclude *rei interitus* in occupational leases and in most cases to include provision for reinstatement of the premises.

## **Conclusion**

We have noted above some of the issues which we encounter in practice when leases are being terminated or not as the case may be. Some of these issues, in particular, the lack of protection for creditors, discourage investment in and funding of some leases which are seen as less commercially attractive when compared with the similar arrangements in England. The added certainty of the correct position in law for landlords and tenants and involvement for creditors in any notification processes will go some way to making Scottish commercial leases a more attractive product.

We have restricted our proposals and comments to matters which are connected to the termination of leases. There are other issues relating to commercial lease which we believe could be considered for reform such as the treatment of options in leases and whether they are binding on successors, the repairing and yielding up clauses in leases in the context of dilapidations to name but two. We would be more than happy to discuss further or provide more information on these issues and any of the issues discussed above.