

Court of Appeal provides clarity as to the question of whether a tenant has a ‘Covid defence’ to a landlord’s claim for rent arrears: **Bank of New York Mellon (International) Ltd v Cine-UK Ltd; London Trocadero (2015) LLP v Picturehouse Cinemas Ltd and others [2022] EWCA Civ 1021**

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The case concerned the combined appeals of *Bank of New York Mellon (International) Ltd v Cine-UK Ltd and others* [2021] EWHC 1013 (QB) (the “**Hengrove case**”) and *London Trocadero (2015) LLP v Picturehouse Cinemas Ltd and others* [2021] EWHC 2591 (Ch) (the “**Trocadero case**”), in which the tenants sought unsuccessfully to resist their respective landlords’ claims for rent for periods when the COVID-19 pandemic meant the demised premises could not be used as a cinema. The Trocadero case involved two leases, dating from 1994 and 2014 respectively, the latter of which followed a reorganisation of the tenants and incorporated all the terms, requirements, covenants and conditions of the 1994 lease for an annual peppercorn rent. No distinction was made between the two leases by the parties or the Court at first instance or upon appeal.

In each case, summary judgment was successfully granted in favour of the landlords on the basis that the tenants had no defence to the claim of rent. The tenants subsequently appealed to the Court of Appeal against those orders.

In both appeals the tenants sought to argue that in respect of the periods when it was unlawful to operate a cinema from the demised premises, the tenants were relieved from the obligation to pay rent for the following reasons:

1. It was fundamental to the basis of the leases that the premises would be capable of lawful use. The effect of the Government regulations making it illegal to use the premises as a cinema caused a failure of that basis, and the tenants would therefore

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have a claim in unjust enrichment in respect of any rent or other sums paid in the illegal periods.

2. It was an implied term that the tenant should be relieved of the obligation to pay rent where the tenant could not lawfully use the premises as a cinema. In the Trocadero case, it was also an implied term that rents would be payable only when the premises could be used as a cinema with attendance commensurate with the levels anticipated at the time the Trocadero leases were entered.

In the Hengrove case, the tenant had an additional ground that it was relieved from the obligation to pay upon a true construction of the rent cesser provision in the lease. A *rent cesser* provision is a clause in a lease that provides for the suspension of a tenant's obligation to pay rent under certain circumstances (e.g. where the whole or part of a premises is damaged or destroyed). In the Hengrove case, the tenant argued that the term "damage" within the lease's rent cesser provision should be interpreted to include not only physical damage, but also financial / non-physical damage of the nature caused by the pandemic restrictions.

At First Instance the Court Found:

Hengrove Case

- The rent cesser clause would only relieve the tenant from the obligation to pay rent in the event that the occupation or use of the property was impeded due to physical damage or destruction affecting the fabric of the building. The most persuasive point in the court's reaching this view being that the tenant's construction of the clause (extending beyond physical damage) did not fit the words used whether taken alone or in the context of the lease as a whole.
- There should not be a term implied into the lease that there should be an equivalent rent cesser in the circumstances, where: (i) COVID and the COVID Regulations were unprecedented, and unforeseen, but had forced the closure of the premises; and (ii) the Landlord had chosen to insure so that the Insured Risks extended to such matters, and had done so at the expense of the Tenants, and in the context where the Leases (and the Insurance) provided for cover to include loss of Rent. This was particularly the case given that (1) the lease was a lengthy standard form professional document which went into great detail about a range of circumstances, with express provisions as to rent cesser limited to physical deterioration, but did not include the term contended for, and (2) the implied term was not necessary to give the lease business efficacy and worked well without it.
- The tenant had not established that the effect of it not being able to operate from the premises in accordance with the Permitted Use resulted in a partial failure of consideration which relieved it from its liability to pay rent.

Trocadero Case

- The Trocadero tenants advanced similar arguments to the Hengrove tenant which

were also rejected by the Court.

- The Trocadero tenant also advanced the argument of failure of basis leading to unjust enrichment. This argument being that the leases had been temporarily frustrated during the lockdown periods at which time the premises could not be used as a cinema (the argued “basis” on which the parties entered into the leases), resulting in rents not being payable during this time. The Court held that this failed due to fact that, taking into account the terms of the leases, the use of the premises was not “fundamental to the basis” on which the parties entered into the leases. The Judge reiterated that the question of whether something was “fundamental to the basis” was to be answered by taking into account the specific terms of the leases and the allocation of risk between the parties. The Court subsequently held that the alleged failure of basis would interfere with the agreed express allocation of risk between the parties and would be inconsistent with the terms of the leases.

Upon Appeal

The Court of Appeal:

1. **Rejected the rent cesser defence in the Hengrove case.** The Court held that the rent cesser provision operated only where there was physical damage or destruction to the property by an Insured Risk (as defined within the lease). This was the correct construction of the provision taken as a whole within the lease.

The Court also confirmed that the high court had been right to conclude the insurance taken out by the landlord was to insure against financial loss to the landlord’s business as a property owner, where the tenant was not legally obliged to pay the rent (such as where the rent cesser provision applied) and not where the tenant had chosen not to pay.

2. **Rejected the proposed implied terms.** In the appeal judgment it was emphasised that where the underlying contracts are detailed documents prepared by lawyers, the scope for implied terms is limited. The Court concluded that both leases worked ‘*perfectly well*’ without the implied term(s), and allocated the risk that the premises could not be used for their intended purpose to the tenant, so that the tenant was obliged to continue to pay rent where the rent cesser provisions were not available.

The Court concluded further that there was nothing unworkable or incoherent about the allocation of risk. And further, that none of the alleged implied terms could be implied into the leases because they were inconsistent with the express terms of the leases, in the sense that they sought to reallocate the allocation of risk set out in the bargain which the parties made.

It also concluded that none of the proposed implied terms satisfied the business efficacy or obviousness tests required to be fulfilled in order for an implied term to be considered valid.

- a. **Business Efficacy test:** *will only be satisfied where, without the implied term, the contract would lack commercial or practical coherence.*

The Court concluded that the leases worked well without the implied terms, and that the proposed term(s) sought to imply into the respective leases a broader cesser of rent provision than the express terms of the leases permitted. Both leases allocated the risk that the premises cannot be used for their intended purpose to the tenant, so that the tenant is obliged to continue to pay rent where the cesser of rent provisions were not applicable

- b. **Obviousness test:** *the term which it is sought to imply has to be precisely expressed and must be so obvious to go without saying.*

The Court emphasised that it was clear that the parties to the leases had turned their minds to what would happen if the premises could not be used by the tenant and that, within the detailed lease documents, had chosen not to make more extensive cesser of rent provisions. This made it doubtful a term to the contrary was obviously implied into the contract. The second implied term alleged in the Trocadero case was also unworkable as there was no evidence or material available from which the Court could assess anticipated cinema attendance levels, and the Court added, even where expert evidence might have been provided, it might well have been disputed – ‘an impossible scenario for the implication of a term’.

3.

Rejected the ‘failure of basis’ (unjust enrichment claim). The Court clarified that as both appeals concerned subsisting contracts, the limitations on the application of the law of unjust enrichment identified in by Carr LJ in *Dargamo Holdings Limited v Avonwick Holding Limited* [2021] EWCA Civ 1149 applied. That being, (i) a claim in unjust enrichment could not contradict the terms of the contract and (ii) for a failure of consideration to be made out despite the existence and performance of a valid contract, it was necessary to identify a ‘gap’ in the contract.

The judge held that there was no “gap” in the leases which required filling by the law of unjust enrichment. The Court emphasised that the leases contained a carefully worked out contractual regime for the allocation of risk and the “proposed failure of basis” would subvert that regime and contradict the terms of the contracts in a way in which the law does not permit.

The Court further clarified that, in the Hengrove and Trocadero cases, it was clear that the consideration for the obligation to pay rent was the demise of the premises for, in each case, a 35 year term, giving the tenant exclusive possession.

Conclusions

The Courts have now made clear that it is the tenant who bears the financial burden in such circumstances and that difficulties faced by tenants during the pandemic will not be accommodated at the expense of developing or departing from existing principles or specific legislation.

The decision is welcome news to landlords who may have been concerned about limited routes to rent arrears recovery during the Covid-19 moratoriums.