



Playing by different rules

Historically English law has distinguished leases from other forms of contract. A lease creates an estate in land and therefore was not regarded in the same light as other contractual bargains. A distinct set of rules evolved to govern the rights and obligations of landlords and tenants in lieu of the ordinary principles of English contract law. Latterly however the courts have been eager to emphasise the contractual nature of a lease as a bargain struck between two parties, amidst judicial observations that the resolution of a dispute ought not to be determined in one manner within a landlord and tenant relationship and in a different manner within another contractual nexus.

This trend is being actively developed in the Commonwealth jurisdictions of Canada and Australia. The Canadian Supreme Court has said that it is no longer sensible to pretend that a commercial lease is simply a land transfer and not a contractual bargain, whilst a landlord's right to sue its tenant for loss of bargain in the form of damages for the loss of future rent following forfeiture of a lease has been recognised by the Australian High Court.

Against this background landlords will be relieved that an attempt by a tenant to argue that English law imposes a duty upon a landlord to mitigate its loss in relation to rent arrears has failed, *Reichman and Dunn v Beveridge and Gauntlett*, [2006] EWCA Civ 1659.

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The Facts

Mr Gauntlett and Miss Beveridge were the tenant of office premises under a five year lease commencing on 26 January 2000. Their rent was payable monthly in advance. In February 2003 their business closed and from 25 March 2003 they stopped paying the rent. In January 2004 the landlord commenced debt recovery proceedings for the rent arrears.

The tenant argued that the rules on mitigation of loss which would apply to a contractual damages claim applied equally to a debt recovery claim such as rent arrears, and the landlord had failed to mitigate its loss either by not forfeiting the lease and attempting to re-let the premises; by failing to accept the offer of a prospective tenant that wished to take an assignment or a new lease; or by failing to accept an offer to negotiate compensation in return for a surrender of the lease.

The Issue

Is a landlord who seeks to recover rent arrears under a duty to mitigate its loss?

The Decision

In *White and Carter (Councils) Limited v McGregor* [1962] the House of Lords held that faced with the repudiation of a contract (not a lease) the innocent party can choose to accept the repudiation and sue for damages, or it can choose not to accept the repudiation and treat the contract as continuing. But there will be a limited number of cases where equity will intervene to prevent an innocent party from enforcing a contract, obliging it to claim damages instead. This will be where the innocent party has no legitimate interest in the performance of the contract and so ought not to be able to impose the burden of performance of the contract on the other party.

The Court of Appeal therefore, applying these principles to the lease in this case, considered if there should be any fetters on a landlord's ability, when it is the innocent party, to insist upon the lease continuing. The answer said the Court depended upon whether damages would be an adequate remedy for the landlord and whether the landlord was being wholly unreasonable in not forfeiting the lease.

The Court found that, in contrast to Australia, in England it is very clear that a landlord's entitlement to future rent comes to an end upon forfeiture. This means that if the landlord were to take back possession of the premises and could only re-let the premises at a lower rent than the rent under the original lease, or indeed, could not re-let the premises at all, it would not be able to sue the defaulting tenant for the rental shortfall. So damages would not be an adequate remedy for the landlord.

Since the lease entitled the defaulting tenant to assign or underlet with the landlord's consent which was not to be unreasonably withheld the Court took the view that, far from being unreasonable, it was positively reasonable for the landlord to hold the tenant to the lease and expect the tenant to shoulder the responsibility of finding a replacement tenant. Additionally, the Court of Appeal was sceptical of any suggestion that the landlord could re-let premises on the defaulting tenant's account and noted that there will always be a significant risk that a landlord who is involved in re-letting premises may inadvertently do something that amounts to a forfeiture of the lease. This risk is also a relevant factor that makes it reasonable for the landlord not to wish to be involved in finding an alternative tenant.

Comment

This unequivocal decision is good news for landlords. Faced with a defaulting tenant in a poor letting market, most landlords will wish to hold their tenant to the original bargain: to have placed a landlord under a duty to mitigate its loss where the tenant is in rent arrears would have been an enormous realignment of the goal posts, and landlords will be thankful that the Court of Appeal declined to do so. However, landlords will need to be careful that they do not take any inadvertent steps that could be regarded as a forfeiture of the lease.

If you have any questions or require specific advice on any matter discussed in this publication, please contact Suzanne Dray (sdray@mayerbrownrowe.com), Charles Leach (charles.leach@mayerbrownrowe.com) or your regular contact in the Real Estate Group.

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