FIRST DIVISION, INNER HOUSE, COURT OF SESSION

[2024] CSIH 22
XA58/23 and XA59/23

Lord President
Lord Malcolm
Lord Pentland

OPINION OF THE COURT

delivered by LORD MALCOLM

in appeals to the Court of Session under section 88
of the Agricultural Holdings (Scotland) Act 2003

by

THE TRUSTEES OF THE EIGHTH EARL CADOGAN'S 1961 SETTLEMENT TRUST

Appellants

against

NEIL BUTLER AND LINSEY BUTLER

Respondents

Appellants: Upton; Lindsays LLP
Respondents: R. Sutherland; Shepherd and Wedderburn LLP

30 July 2024

Introduction

[1] Neil and Linsey Butler are the joint tenants of Stewart Tower Farm, Stanley, Perthshire. (It is currently farmed along with a smaller contiguous holding.) The landlords

are the trustees of the Eighth Earl Cadogan's 1961 Settlement Trust. They wish to exercise a power of resumption contained in the lease and recover possession of two of four cottages currently forming part of the holding for their sale or letting. The tenants applied to the Scottish Land Court for a declaration that the landlords have no right to do this. In terms of section 39(2) of the Agricultural Holdings (Scotland) Act 1991 the court was also asked to approve a contested improvements notice served on the landlords in respect of two new agricultural buildings which the tenants wish to construct, namely a new cattle shed and a smaller covered walkway at a cost in the region of £200,000. The landlords objected, claiming that, among other things, the improvements would be inconsistent with the type of farming specified in the lease.

[2] After hearing evidence and submissions, and with the benefit of a site inspection, the court: (1) declared that the resumption notice was contrary to the good faith of the lease and (2) approved the improvements notice but only for one of the buildings, see SLC/103/22 and SLC/17/23, orders issued on 27 November 2023. The landlords have appealed both decisions to this court. Though strictly separate matters, the appeals were heard together.

The lease

[3] The agricultural lease extends to some 300 acres or thereby and was executed in 1951 with a 14 year term. Clause FIFTH provides: "The farm is not let as a dairy farm but in the event of the farm being converted to use as a dairy farm by the tenant he shall not be required to demolish or reconvert the relative buildings or be liable in dilapidations to that end at the termination of the lease." Clause EIGHTH of the articles annexed to the lease states: "The subjects let shall be used for agricultural purposes only and for the production of the cereal, green and grass crops customary in the district and also for the rearing and

fattening of cattle and sheep. The proprietor shall not be under any obligation to equip the farm for the manufacture of any of the produce of the farm, or for the sale of milk or other dairy produce, or for market gardening, or for the production of fruit, poultry or pigs, or for the breeding of horses and pedigreed stock or for the keeping or breeding of tuberculin tested animals." In terms of clause THREE of a 1974 minute of extension: "The proprietors will be responsible for the cost of re-roofing the cattle courts on the subjects of let in terms as agreed between the parties. The tenants will be responsible for the capital expenditure incurred in the provision of a dairy parlour, collection area, feed loft and slurry pit. They will have no right to compensation whatsoever from the proprietors for any of the said works carried out by them at their waygo or at termination of the lease."

[4] Clause FOURTH of the lease required the landlords to modernise the four farm cottages and introduce a water supply to them and elsewhere. In clause SECOND of the annexed articles a power was reserved to the landlords and their successors to resume possession of such land as may be required for certain specified matters and for unspecified "other purposes", with a consequential rent reduction.

The tenants' farming enterprise on the holding

[5] Linsey Butler is the granddaughter of Allan Wilson, the first tenant. The current landlords purchased the farm from the Murthly & Strathbraan Estates in 1998. When in 1951 the lease was being negotiated the then proprietors knew that it was to be used as a dairy farm, hence the relative provisions in the lease. Mr Wilson's dairy herd was being brought from East Kilbride, his farm there having been developed to help create the new town. Milk production ceased in 1989 but by the time of the purchase by the current landlords, and as mentioned in the sale particulars, a small dairy herd had been re-

established using the milking parlour and other equipment on the property. Since then the tenants have grown their livestock and dairying business and the arable operation. In addition, following a diversification notice served in 2005, there is an ice cream parlour, café and shop. The tenants, who wish to expand the dairy herd, consider that the current accommodation for cattle is outdated, unsatisfactory and requires replacement to allow the dairy herd to be managed in a fit for purpose facility. As to the cottages, the view is that they are required for farm employees.

The Land Court's decision refusing resumption of the cottages

[6] While the lease is not of a dairy holding, it and the minute of extension expressly anticipate that dairy farming may be carried out. When assessing the resumption notice one must construe the lease as a whole. Based on the current use of the holding, including the dairy business, the court accepted evidence that four on site units of accommodation are required. Given that the farmhouse can be used by one worker, it followed that resumption of two of the four cottages would be problematic for the tenants. It would prejudice their ability to attract and retain good employees. That the lease required the proprietor to modernise all of the cottages is strongly indicative that they were a material part of the lease.

[7] In what was recognised as a marginal case it was held that resumption of two of the cottages could not reasonably be regarded as within the contemplation of the parties and thus would be contrary to the good faith of the lease (which is an established basis for striking down a resumption notice). The court might have been sympathetic to the resumption of one cottage but the landlords insisted on the current application.

The Land Court's decision on the improvements notice

[8] The lease excludes any liability on the landlords to pay compensation at termination for tenants' dairy improvements. Accordingly dairying activity is irrelevant to the question of compensation for improvements. (It can be noted that the purpose of seeking the court's approval is to preserve compensation rights, section 34(1)). The smaller building, the covered walkway shed, has no obvious application to arable or livestock farming; it would be purely for dairy purposes. However, applying what was described as an objective test, the court held that the new cattle shed and ancillary works were reasonable and desirable on agricultural grounds for the efficient management of the holding. It was reasonably required to allow "the type of farming specified in the lease". In context clearly this was intended as meaning that even in the absence of a dairy herd the new shed would be needed.

[9] The court held that the existing cattle shed has multiple age related defects which would normally be addressed by new accommodation. It is too small for modern machinery access, including that used in arable farming. It is no longer wind and watertight. The feed passage arrangements are unsatisfactory and there is a need for additional short term cereal storage. It mattered not that the intention was to use the building for dairy farming - the improvement would be needed whichever type of farming was adopted. Approval was granted for the new cattle shed, but not for the other building.

A summary of the landlords' submissions in support of the appeal against the resumption decision

[10] The holding was not let as a dairy farm (clause FIFTH) and the rent is not assessed on that basis. The purpose of the lease was restricted to arable and livestock farming. As in

the improvements decision, the materiality of the cottages is judged by reference to the kind of farming for which the holding is let. The demands of the dairy operation are irrelevant to that exercise. Given that the two cottages are needed because of that part of the business, it followed that they are not material to the lease and there can be no valid objection to the exercise of the agreed power of resumption. It cannot have been contemplated that the tenants could keep the cottages for a purpose for which they pay no rent. In the absence of resumption the landlords' repairing obligations will continue.

[11] A modernisation requirement in 1951 has no relevance to the parties' understanding as to what might happen over 70 years later. Furthermore, the court made no reference to unchallenged evidence led for the landlords that since 1998 a minimum of two cottages have been sublet. The parties cannot have contemplated that cottages redundant for 25 years were material to the holding. The extent of the land proposed to be resumed bears no relation to that involved in previous cases where a materiality objection has been upheld. Robust justification is required to defeat the exercise of a resumption clause; that it would be "problematic" for the tenants' business is not enough.

A summary of the tenants' submissions in response on the resumption issue

[12] While not let as a dairy farm, it was contemplated that the tenants could at their expense convert and use the holding for dairying, but with no obligation on the landlords to facilitate this, nor to compensate the tenants for the improvements at outgo. Equally the tenants would not be required to demolish or reconvert buildings or pay dilapidations. There is no prohibition on the cottages being occupied by dairy workers. The modernisation requirement shed light on the parties' understanding as to the importance of all four cottages.

[13] When judging the materiality of the cottages, the rent paid is of no relevance. The deemed intention of the parties is judged as at the date of the lease, not by reference to the recent use of the cottages. There has been no challenge to the findings as to the impact of resumption on a use contemplated by the lease. In holding that at least three cottages were required, the Land Court applied the correct test and reached a decision which was open to it.

A summary of the landlords' submissions on the improvements decision

[14] The landlords have repairing, replacement and renewal obligations in terms of section 5 of the 1991 Act. Mr Butler stated that the landlords' failure to repair and replace the fixed equipment rendered the improvements reasonably necessary. The comparison should have been with a properly repaired building, not with its current condition. Unless demonstrated that it would be insufficient, the tenants' remedy is to enforce the landlords' duties concerning the fixed equipment. The Land Court erred by not having regard to the tenants' rights under section 5.

[15] In any event, the new cattle shed is wanted for the dairy business. It follows that it is not needed for the purposes specified in the lease, namely mixed arable and livestock farming.

The tenants' submissions on the improvements notice decision

[16] The landlords' first ground of appeal was not argued before the Land Court. In any event section 5 addresses a wholly separate and distinct matter. The legal test for approval of an improvement is not controversial – is it reasonable and desirable on agricultural grounds for the efficient management of the holding? The landlords offered nothing by way

of a repaired or replaced building. The court had to decide the issue before it on the evidence led.

[17] As to the second ground, the lease does not restrict livestock to a minor element in the business. The tenants are permitted to operate a dairy farm. As a specialist body, the court was entitled to conclude that the new building would be required for the non-dairy specific needs of a livestock and arable farm.

[18] Both parties made reference to a number of authorities, many of which are mentioned in the discussion below.

Analysis in respect of the resumption appeal

[19] The common law governs a landlord's power to exercise a contractual right to resume part of the tenanted subjects. (The statutory notice to quit provisions do not apply, see section 21(7)(a) of the 1991 Act.) While the parties to an agricultural lease are free to bargain as they wish on the matter, there are circumstances in which a resumption notice will be declared invalid. Some general principles can be derived from the case law.

[20] The first question is whether the proposed resumption falls within the scope of the terms of the resumption clause. For example, some restrict the purposes for which land can be retaken. This issue does not arise here, but nonetheless it is recognised that other considerations might render a resumption notice invalid. In each case it is a question of examining the full circumstances and the whole terms of the lease, and then determining whether the intended resumption could reasonably have been within the contemplation of the parties to it. If not, they have not agreed to the resumption. It is contrary to the good faith of the lease, or as it is sometimes put, a fraud on the lease. An example would be if the remainder of the holding will not be a viable economic unit, *The Admiralty* v *Burns*, 1910 SC

531. Another such case would be if a general purpose resumption clause was used with a view to recovering land so that the landlord or a third party could farm it, *Turner* v *Wilson,* 1954 SC 296; *Pigott* v *Robson,* 1958 SLT 49.

[21] The proper approach to cases of this kind was discussed in detail in *Fothringham* v *Fotheringham,* 1987 SLT (Land Ct.) 10. It involved the proposed resumption for forestry of 3,212 acres of a 4,633 acre hill sheep farm, 640 acres of which had already been resumed by agreement. The landlords were again the Murthly & Strathbraan Estates and the resumption clause in the 1954 lease was in identical terms to that in the present case. It was held that, although remaining a viable unit, such a radical change in the nature and character of the holding, removing almost all of the hill ground and converting the holding into an upland farm with a different system of husbandry, could not have been contemplated when the lease was agreed in 1954.

[22] Reference was made to Lord Salvesen's opinion in *The Admiralty* v *Burns* that, leaving aside extreme cases where the whole purpose of the lease would be undermined, the question is "whether the land sought to be resumed forms so material a part of the subjects let that [its resumption] cannot be reasonably regarded as within the contemplation of and would be against the good faith of the bargain embodied in the lease." It was noted that in *Glencruitten Trs* v *Love*, 1966 SLT (Land Ct.) 5 it was held that an agreed right to resume "any part of the lands" did not allow repossession of the steading, associated buildings and courtyard. The steading played such an important part in the management of the tenant's farming business that it was so material a part of the subjects that its resumption could not reasonably be regarded as contemplated and thus would be against the good faith of the parties' bargain.

[23] Every case will depend upon its own facts and circumstances, with an evaluation required as to the materiality of the subjects concerned to the lease, and regard being had to all its terms. In *Fothringham* it was important that the holding was let as a traditional hill sheep farm with a duty to maintain the existing ewe flock "properly belonging to the farm" of pure bred black faces. It was not simply a question of the viability or otherwise of the retained land as a farming unit. Without the hill ground the tenant's sheep stock obligations could no longer be met, thus the resumption of more or less all of it was not within the contemplation of the lease. The whole character of the farm would be altered in a manner inconsistent with the parties' original bargain.

[24] It would be wrong to draw the conclusion that a resumption for a valid purpose which does not alter the character of the holding and leaves the tenant with a viable business is necessarily beyond challenge. It will always be a matter of ascertaining the deemed intention of the parties to the lease at the time it was agreed and assessing whether what is now intended by the landlord is contrary to the implied good faith of the bargain. In *Thomson* v *Murray*, 1990 SLT (Land Ct.) 45 the "so material" test for being beyond reasonable contemplation was described as a "strict test". We doubt that such language is appropriate to what is in essence a traditional exercise of construction of contract, albeit it can be recognised that the starting point is that a power of resumption was agreed and that nearly all resumptions will have some impact on the use of the farm.

[25] The expert knowledge and experience of the Land Court is brought to bear in cases of this kind, and we are mindful of the limitations on the jurisdiction of this court to interfere with its decisions, see *Jardine* v *Murray*, 2012 SC 185 at para 80. An appeal will succeed only if there has been an error in law, section 88 of the Agricultural Holdings

(Scotland) Act 2003. Matters of fact, evaluation and the weight to be attached to the relevant factors are for the specialist tribunal entrusted with the decision-making task.

[26] In respect of the tenants' challenge to the resumption notice the court applied a now well established test. There is no challenge to any of its findings of fact, for example as to the importance of at least three on site units of accommodation for farm workers. It is said that the court erred by judging the matter by reference to the needs of the dairy business, a purpose for which, as per clause FIFTH, the land was not let. However it was correctly recognised that dairying was permitted by the lease, and indeed was expressly contemplated as a use of the holding. The landlords' proposition that dairying was not the mutual purpose is misconceived. When the lease and the minute of extension are read as a whole it is clear that the purpose of the reference to the land not being let as a dairy farm was to limit the landlords' executory and financial obligations, such as the provision of fixed equipment and compensation liabilities, to those appropriate to arable and livestock farming. Thus it was for the tenants at their own expense to provide and maintain the equipment required for the anticipated dairy operation, albeit they were not obliged to remove it at outgo.

[27] The Land Court did not err by assessing the materiality of the cottages to the business as a whole, including the dairy element. To use the language adopted in *Glencruitten Trs*, the nature and character of the holding was that of mixed arable and livestock, with permission to have a dairy herd, albeit in respect of the latter without correlative obligations on the landlords. In these circumstances it would have been erroneous to assess the validity of a resumption clause without reference to the requirements of the dairy operation.

[28] The landlords emphasise that the dairy use is not taken into account when determining the level of rent, however that simply reflects the structure of the bargain as just mentioned. It is of no relevance to the materiality of the cottages for a farming operation contemplated in the lease.

[29] It is contended that in judging whether all of the cottages are an important part of the let subjects it was wrong to place importance on a provision in a lease executed in 1951 obliging the landlords to modernise all of the cottages. We do not agree. The matter is determined by reference to the deemed intention of the parties when the lease was made. The passage of time does not alter the answer to that question.

[30] Similarly the sub-letting of cottages in more recent years is not determinative. As the court observed, regard is had to a hypothetical tenant in the context of the lease as a whole, with the focus on the nature of the holding set out therein, not on the current tenants' business model. In any event it can be noted that the court also noted that the tenants' use of the land closely reflects the terms of the lease. As to the cottages sought to be recovered, the evidence was that one is occupied by the farm manager and the other was vacant pending renovation to allow its occupancy by an employee.

[31] In summary we have detected no error of law on the part of the Land Court. It had regard to the relevant considerations, applied the correct test, and reached a decision open to it on whether the impact of resumption of two cottages was so material as to be against the good faith of the lease. Again we stress that it is not for this court to trespass on matters which are for the judgement of the expert tribunal.

Analysis of the challenge to the improvements notice determination

[32] There is no appeal against it, and at first glance the decision that approval should be

withheld for the covered walkway shed because it had no utility for anything other than the dairy business might seem inconsistent with the reasoning deployed in respect of the resumption notice; in particular the reference in the improvements decision to mixed arable/livestock being "the type of farming specified in the lease". However, bearing in mind that the only purpose in seeking the court's approval is to preserve the tenants' eligibility for compensation rights for an improvement at outgo, on closer analysis it is apparent that there is no conflict. As the Land Court explained, this is because the covered walkway would be a purely dairy related improvement which the lease explains should be at the tenants' expense with no related financial obligations upon the landlords. It was to achieve this and similar outcomes that, despite contemplating dairying, it was specified that the holding was not let as a dairy farm. To grant approval for the covered walkway and thereby open up future compensation rights for the tenant at outgo would have been contrary to the terms of the lease. No such complication arose in respect of the assessment of the resumption notice.

[33] The same objection to approval did not arise regarding the notice concerning the new cattle shed. Because of the deficiencies in the current building, a new shed would be reasonably required even in the absence of a dairy herd. Contrary to the landlords' contention, the intention of the current tenants to use it for dairying purposes has no impact on what is an objective and straightforward test for approval of the proposed improvement, namely is it reasonable and desirable on agricultural grounds for the efficient management of the holding? There has been no challenge to the relevant findings in fact on this issue, and the answer remains yes, no matter whether the livestock does or does not include dairy cows.

[34] The other complaint is that the court should have asked itself whether a properly repaired or replaced cattle shed as per the landlords' obligations regarding the fixed equipment under section 5 of the 1991 Act would be sufficient, and if yes, ruling out the new shed. We have difficulty in finding this argument in the submissions made to the Land Court, and no reference is made to it in the judgment. In any event we are satisfied that the tenants' response that the 1991 Act provides a stand-alone code for compensation for tenants' improvements is correct. Section 5 deals with a different matter, namely a landlord's duties regarding the fixed equipment on the farm. It does not prevent or inhibit a tenant from giving notice of proposed improvements, *R & M Whiteford* v *Trustees for the Cowhill Trust,* 2009 SLCR 188 at para 246, and *Alston* v *Earl of Mansfield's Trs,* SLC/87/12, order of 17 April 2013, para 25.

[35] At no stage did the landlords respond by way of a considered proposal of their own. It is hard to see on what realistic basis the court could have refused approval because if and when the landlords repaired, replaced or renewed the cattle shed that might be sufficient for the proper management of the holding.

Disposal

[36] For these reasons both appeals are refused and the Land Court's determinations confirmed.