Easter Term
[2014] UKSC 27
On appeal from: [2012] CSIH 83

JUDGMENT

L Batley Pet Products Limited (Appellant) *v* North Lanarkshire Council (Respondent) (Scotland)

before

Lady Hale, Deputy President
Lord Kerr
Lord Reed
Lord Carnwath
Lord Hodge

JUDGMENT GIVEN ON

8 May 2014

Heard on 17 March 2014

Appellant
Roy Martin QC
David J T Logan
(Instructed by Balfour & Manson)

Respondent
Mark Lindsay QC
John MacGregor
(Instructed by Ledingham Chalmers)

LORD HODGE (with whom Lady Hale, Lord Kerr, Lord Reed and Lord Carnwath agree)

1. This appeal raises two issues of contractual construction in documents relating to the letting of commercial premises at 1 and 3 South Wardpark Place, Wardpark South Industrial Estate, Cumbernauld, Scotland. The appellant ("Batley") is the mid-landlord of sub-let premises and the respondent ("the Council") is the sub-tenant. Batley and the Council disagree on whether the Council was obliged to remove its alterations and reinstate the sub-let premises on the expiry of the sub-lease when the request to do so was made orally by Batley's surveyor and not put in writing in a schedule of dilapidations or otherwise before the sub-lease expired. The two issues are:

> (a) whether under a minute of agreement that authorised alterations to the sub-let premises Batley was obliged to give written notification that it required the Council to remove the alterations and reinstate the sublet premises; and
> (b) whether under the repairing obligation in the head lease, which was applied to the sub-lease, Batley had to give a written notification that it required the Council to carry out the repairs before the expiry of the sub-lease.

As the repairing obligation in the head lease is in terms which are commonly used in commercial leases, the appeal from the decision of the Extra Division of the Inner House of the Court of Session raises an issue of law of general importance.

The relevant contracts

2. The head lease, which is dated 18 and 25 October 1995, granted the tenant a lease of the premises for 25 years until 8 October 2020. Batley acquired the tenant's interest in the head lease in 2007. Clause 3 of the head lease imposed obligations on the tenant, including obligations to repair, maintain and renew the premises (cl 3.12), to maintain the landscaped areas (cl 3.13) and to decorate the exterior and interior of the premises (cls 3.14 & 3.15). As the first of those obligations is in issue, I set out the relevant parts of cl 3.12:

> "At all times throughout the Period of this Lease at the Tenant's expense well and substantially to repair, maintain and where necessary to renew, rebuild and reinstate and generally in all respects keep in

> good and tenantable condition the Premises … and every part thereof with all necessary maintenance, cleansing and rebuilding and renewal works and amendments whatsoever regardless of the age or state of dilapidation of the buildings for the time being comprised in the Premises and irrespective of the cause or extent of the damage necessitating such repair, maintenance, renewal, rebuilding or others and including any which may be rendered necessary by any latent or inherent defects in the Premises …"

The tenant also had to permit the landlord to inspect the premises (cl 3.18) and was obliged to comply with any notices in writing by the landlord identifying a failure to comply with its obligations to repair (cl 3.19).

3. The tenant had to obtain the landlord's prior written consent to alterations to the premises (cl 3.25(a) & (b)). Although various clauses of the lease generally required written notices, written consents and written approvals, clause 5.8 stated "Any notice, request, demand or consent shall be in writing" and specified what amounted to sufficient service.

4. The sub-lease to the Council of part of the premises was dated 26 February and 19 March 1998. Its date of expiry was 19 February 2008 but Batley and the Council varied the sub-lease to extend it to 18 February 2009. Clause 5 of the sub-lease provided:

> "The Sub-tenant also undertakes with the Mid-Landlord and binds and obliges its successors and assignees whomsoever throughout the Period of the Sub-Lease as follows:-
>
> 5.1 <u>Fulfilment of Mid-Landlord's obligations</u>
>
> Save in so far as inconsistent with the express terms of the Sub-Lease to fulfil, perform and observe to the relief of the Mid-Landlord the obligations and restrictions of a non-monetary nature undertaken by or imposed upon the Mid-Landlord under the Lease so far as they relate to the Premises and as if references in the Lease to "the Premises" were references to the Premises as defined in the Sub-Lease and that in accordance with the terms of the Lease.
>
> …

5.3 Expenses

to reimburse to the Mid-Landlord all proper and reasonable costs and expenses incurred by the Mid-Landlord:-

5.3.1 incidental to the preparation and service of all notices and schedules relating to deficiencies in repair or requiring the Sub-Tenant to remedy the breach of any of its obligations under the Sub-Lease whether the same be served before or after the Date of Expiry;

5.3.2 in the preparation and service of a schedule of dilapidations at any time before or after the Date of Expiry;

5.3.3 in procuring the remedy of any breach of any obligation on the part of the Sub-Tenant under the Sub-Lease."

5. Clause 5.7 of the sub-lease provided that alterations of the sub-let subjects required the prior written consent of the mid-Landlord. Clause 8 contained an irritancy (forfeiture) clause in the event of any breach of any of the undertakings of the sub-tenant under the sub-lease. Clause 13, on which the Council founds, provided:

"The provisions for notices contained in Clause 5.8 of the Lease shall apply also under the Sub-Lease as if "the Mid-Landlord" had been substituted for "the Landlord" and "the Sub-tenant" had been substituted for "the Tenant".

Thus, under the sub-lease any "notice, request, demand or consent" had to be in writing.

6. The third agreement is the Minute of Agreement dated 7 and 17 April 1998 by which the then mid-landlord licensed the Council to make alterations to the sub-let premises subject to conditions. Clause 2 of the Minute of Agreement imposed obligations on the sub-tenant to obtain the needed planning and other permissions (cl 2.1), to notify the mid-landlord of the commencement and completion of the works (cl 2.2), to indemnify the mid-landlord (cl 2.3) and to permit the mid-landlord and its surveyors to inspect the progress of the works (cl 2.4). The obligation at the heart of the present dispute is clause 2.5 which provided:

> "By the expiration and sooner determination of the period of the Sub-Lease (or as soon as the licence hereby granted shall become void) if so required by the Mid-Landlord and at the cost of the Sub-tenant to dismantle and remove the Works and to reinstate and make good the Premises and to restore it to its appearance at the date of entry under the Sub-Lease, such reinstatement to be carried out in the same terms (*mutatis mutandis*) as are stipulated in this Licence with respect to the carrying out of the Works in the first place (including as to consents, the manner of carrying out works, reinstatement, inspection, indemnity, costs and otherwise)."

Counsel agreed that the word "and" (which I have underlined) should be read as "or".

7. The issue between the parties on that clause is whether the mid-landlord had to put in writing before the expiration of the sub-lease its requirement for the sub-tenant to dismantle and remove the alterations and to reinstate the premises. This is because clause 5 of the Minute of Agreement stated:

> "Obligations of Tenant incorporated into Lease
>
> That during the execution of the Works and when the same shall have been completed all the undertakings and obligations on the part of the Sub-Tenant herein contained shall be deemed to be incorporated in the Sub-Lease and the power of irritancy contained in the Sub-Lease shall be construed and have effect accordingly."

Finally, clause 7 provided that "[e]xcept in so far as amended hereby" the parties ratified and confirmed the whole terms of the sub-lease.

8. Counsel did not know whether and on what terms the head landlord had consented to the sub-tenant's alterations.

Batley's claim and the decisions below

9. Batley presented its claim on alternative bases:

(a) Under the Minute of Agreement it claimed £253,766.44 for both the removal of the alterations and the repair of the sub-let premises; and in the alternative

(b) under clause 5 of the sublease, which imposed on the Council the obligations of clause 3.12 of the lease, it claimed £189,692.30 for repair of the sub-let premises (excluding the removal of the alterations).

The Council challenged the legal relevancy of Batley's case. Temporary Judge Wise QC concluded that Batley had pleaded a relevant case because she construed clause 2.5 of the Minute of Agreement as allowing Batley to communicate orally that it required the reinstatement of the sub-let premises. She allowed the parties a proof before answer of their averments. *Per incuriam* in her interlocutor of 20 December 2011 she repelled the Council's plea to the relevancy (plea in law 1).

10. The Extra Division (Lord Clarke, Lord Hardie and Lord Bonomy) in an opinion dated 7 November 2012 granted the Council's reclaiming motion and dismissed Batley's action. They held that absent a written notice before the expiry of the sub-lease, the Council was not obliged under clause 2.5 of the Minute of Agreement to dismantle and remove the works and reinstate the sub-let premises. They also held that Batley had not averred a relevant basis for its alternative claim. They referred to the Council's submission that Batley had not pleaded that they had given the Council any indication before the expiry of the sub-lease that any work was required under clause 3.12 of the head lease. They concluded that Batley had no sufficient averments of the obligations for which it sought relief. Batley appeals to this court.

This appeal

11. I address the second basis ((b) in para 9 above) before I turn to Batley's primary case because it has a bearing on the construction of the provisions that are relevant to that case. I recognise that Batley's pleadings are not detailed but they refer to the Council's obligations under clause 5.1 of the sub-lease in relation to the obligation to repair and quote the relevant part of clause 3.12 of the head lease, specifying the tenant's obligation to repair and maintain the premises "at all times throughout the period of [the] lease". Batley also avers that the necessary repair works were specified in the column described as "costs ex strip out" in the revised schedule of dilapidations. In my view the pleadings give notice of both the contractual basis of the claim and also, by reference to the revised schedule, the works which Batley asserts were required at the expiry of the sub-lease to meet the obligation to repair. The question whether the identified works relate to the condition of the sub-let premises within the period of the sub-lease is a matter for proof.

12. Before us, Mr Lindsay sought to defend the Extra Division's dismissal of Batley's second basis on the grounds (i) that the claim arose under clause 2.5 of the Minute of Agreement which prevailed over the sub-lease and required written notice, (ii) that Batley's claim was under clause 5.3 of the sub-lease and it had not carried out the repair works which entitled it to reimbursement, (iii) that Batley had not averred that the defects occurred during the currency of the sub-lease and (iv) that Batley had not given written notice to the Council of the requirement to repair and reinstate before the expiry of the sub-lease.

13. I can deal with the first three points shortly. First, clause 2.5 of the Minute of Agreement is focused on the removal of the licensed works. An overlap of the clause 2.5 obligations with the obligations under clause 5.1 of the sub-lease does not impose a requirement of written notice as a trigger for the latter if none otherwise existed. Mr Lindsay's submission drew on Batley's argument that there was a hierarchy of contractual documents with the Minute of Agreement at its peak. I do not accept that such a hierarchy exists; the Minute of Agreement is simply a means of giving consent under clause 5.7 of the sub-lease. It is separate from rather than superior to the lease and the sub-lease. Secondly, Batley's claim is under clause 5.1 of the sub-lease (para 4 above) which obliges the Council to perform the mid-landlord's non-monetary obligations in relation to the sub-let premises. A claim for damages is available for breach of that obligation and exists alongside the mid-landlord's right to reimbursement under clause 5.3. If Batley has not carried out the works, a claim based on the estimated cost of those works may be a legitimate measure of its loss: *Duke of Portland v Wood's Trustees* 1926 SC 640, *per* Lord President Clyde at 650-651. Thirdly, it is implicit in Batley's claim under clause 5.1 that it is asserting that the sums listed in the "costs ex strip out" column of the schedule of dilapidations relate to Batley's obligations under clause 5.1.

14. The fourth point is important, because the Extra Division, in accepting the Council's submission, appear (in para 18 of their opinion) to have imposed on a landlord a hurdle that is not there. Clause 3.12 of the head lease, which obliges the tenant to repair, maintain and where necessary reinstate the premises in order to keep them in a tenantable condition at all times during the period of the lease, is an obligation to keep premises in (and put them into) a good condition. It imposes a continuing obligation on the tenant which does not require any notice from the landlord to activate it. It is well established that clauses of that nature have this effect. In *Credit Suisse v Beegas Nominees Ltd* [1994] 4 All ER 803, Lindsay J stated (at 821g-h)

> "Whilst I accept the inevitability of the conclusion of the Court of Appeal in *Post Office v Aquarius Properties Ltd* [1987] 1 All ER 1055 that one cannot have an existing obligation to repair unless and until there is disrepair, that reasoning does not apply to a covenant to keep (and put) into good and tenantable condition. One cannot sensibly

> proceed from 'no disrepair, ergo no need to repair' to 'no disrepair, ergo no need to put or keep in the required condition'. Leaving aside cases, such as this, where there is special provision for there to have been prior knowledge or notice in the covenantor, all that is needed, in general terms, to trigger a need for activity under an obligation to keep in (and put into) a given condition is that the subject matter is out of that condition."

There are two first instance decisions by Lord Penrose that Scots law is to the same effect: *Taylor Woodrow Property Co v Strathclyde Regional Council* unreported, 15 December 1995, and *Lowe v Quayle Munro Ltd* 1997 SC 346, at 351. In my view they are correct. There is no requirement of notice from the landlord, in writing or otherwise, during the currency of a lease to trigger this obligation.

15. I am satisfied therefore that Batley has pleaded a case on basis (b) that is relevant to go to proof before answer. Issues of fact, such as whether Batley has carried out the needed repairs, and, if it has, the legal consequences to its claim (which is based on estimated costs) can be addressed at that hearing.

16. Batley's principal claim (basis (a) in para 9 above) depends on the correct construction of the Minute of Agreement. The question is whether Batley had to give written notice before the expiry of the sub-lease of its requirement that the Council remove the licensed works. It is not straightforward as the document can bear more than one interpretation, but I conclude that no written notice was required.

17. Mr Lindsay argued, first, that the Minute of Agreement should be read in the context of the lease and the sub-lease, which each provided for notices, requests, demands and consents to be in writing: clause 5.8 of the head lease and clause 13 of the sub-lease. Secondly, he submitted that it made commercial sense to have the requirement in writing so that the parties could be certain whether and to what extent the mid-landlord required the sub-tenant to remove the licensed works. The requirement for written notice was not burdensome and it would be anomalous if, in the context of the three contracts, written notification was not needed to impose this requirement. Accordingly, the Council argued that clauses 5 and 7 of the Minute of Agreement should be construed as incorporating the notice provisions of clause 5.8 of the head lease into the Minute of Agreement.

18. Attractively presented though those submissions were, I am not persuaded. In *Rainy Sky SA v Kookmin Bank* [2011] 1 WLR 2900, Lord Clarke of Stone-cum-Ebony stated (at para 21):

> "[T]he exercise of construction is essentially one unitary exercise in which the court must consider the language used and ascertain what a reasonable person, that is a person who has all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract, would have understood the parties to have meant. In doing so, the court must have regard to all the relevant surrounding circumstances. If there are two possible constructions, the court is entitled to prefer the construction which is consistent with business common sense and to reject the other."

The starting point is the words the parties have chosen to use. See also *Multi-Link Leisure Developments Ltd v North Lanarkshire Council* 2011 SC (UKSC) 53, Lord Hope at para 21. The words must be construed in the context of the Minute of Agreement as a whole and having regard to the admissible background knowledge, which is often called "the factual matrix".

19. Starting with the words of the Minute of Agreement, I note that the disputed words in clause 2.5 ("if so required by the Mid-Landlord") contrast with two provisions in the Minute of Agreement which expressly require written forms. First, there was the requirement in clause 2.1.2 that the sub-tenant produce all needed permissions for alteration to the mid-landlord and obtain the mid-landlord's "written acknowledgement" that it was satisfied with the permissions. Secondly, clause 3 empowered the mid-landlord to nullify the licence if the sub-tenant did not complete the works within the time limit of 16 weeks or breached its undertakings and obligations and failed to remedy such breaches within a reasonable period "following a notice by the Mid-landlord to the Sub-tenant specifying the breach complained of…" (my emphasis).

20. Other provisions in the Minute of Agreement did not expressly require writing. Thus in clause 2.1.3 the sub-tenant was to give such information as might be "reasonably required" by the mid-landlord that it had complied with its undertakings and obligations before commencing the licensed works. Clause 2.2.2 obliged the sub-tenant to "notify" the mid-landlord after the commencement and the completion of those works. The concluding words of clause 2.5, which deal with the reinstatement works, incorporated the provisions of clause 2 (including 2.1 and 2.2). It appears that in this document the parties stated expressly when a communication had to be in writing and when more informal communication was permitted.

21. Further, contrary to the Council's submission, nothing was incorporated into the Minute of Agreement. Clause 5 (para 7 above) deemed "the undertakings and obligations on the part of the Sub-Tenant herein contained" to be incorporated into

the sub-Lease. The purpose of that deemed incorporation is clear in the concluding words of clause 5: it was to give the mid-landlord the power of irritancy (forfeiture) of the sub-lease if the sub-tenant breached its obligations under the Minute of Agreement. In my view the Council's case depends on a rather convoluted argument that clause 5 of the Minute of Agreement subjected clause 2.5 to the requirement of writing (in clause 5.8 of the head lease) because the sub-tenant's obligation in that clause was conditional upon the mid-landlord requiring the sub-tenant to remove the licensed works. I strongly prefer the simpler construction of clause 5 of the Minute of Agreement.

22. Clause 7 of the Minute of Agreement is in my view neutral on the issue that divides the parties. The Minute of Agreement was not a deed of variation of the sub-lease and I do not construe it as having amended the sub-lease at all. But if I am wrong and the sub-lease was amended, clause 7, which is a saving provision, limits the amendment to the deemed incorporation. It does not tell what was so incorporated.

23. It is also relevant to see the Minute of Agreement in its context as a document required by clause 5.7 of the sub-lease: the mid-landlord's consent to the sub-tenant's works. The Minute of Agreement exists in the context of the head lease and the sub-lease, both of which are part of the factual matrix. But it is a separate contract and, as I have said, the starting point is the words which it contains. Those words point towards the conclusion that writing was not required for communications in all circumstances. The fact that the communications in the head lease and the sub-lease that fell within the scope of clause 5.8 of the former had to be in writing does not overturn that conclusion.

24. I do not think that the construction which I favour lacks business common sense. On the contrary. First, as I have said, clause 5 of the Minute of Agreement states the commercial purpose of the deemed incorporation of the obligations into the sub-lease: to give the mid-landlord the power of irritancy. Secondly, the context is important; the landlord would require the removal of the licensed works only at the end of the sub-lease, when the sub-tenant would have to address its separate and continuing obligation to keep the property in repair. See para 14 above. Intimation by or on behalf of the mid-landlord that it required the removal of the licensed works required no formality. A sub-tenant that conscientiously addressed its mind to its obligations under clause 5.1 of the sub-lease to keep the sub-let premises in repair could readily respond to an intimation by the mid-landlord or its surveyor that it include the removal of the licensed works in the works it carried out at the end of the sub-lease. If in doubt, it could ask the mid-landlord. The benefits of certainty, which Mr Lindsay emphasised, do not make the Council's interpretation of the Minute the only commercially sensible construction.

25. I am therefore satisfied that the Minute of Agreement did not require the mid-landlord to give written notice of its requirement that the licensed works be removed at the end of the sub-lease. Batley avers that it instructed a named firm of chartered surveyors to produce a schedule of dilapidations and that on 22 December 2008 a named surveyor from that firm informed a named official of the Council that the mid-landlord would be requiring the reinstatement of the premises to their original condition. Those averments meet the well-known test of relevancy in *Jamieson v Jamieson* 1952 SC (HL) 44, Lord Normand at 49-50. The appellant is not to plead evidence; and as the Council can not only enquire of its official but also take steps to recover from Batley and the surveyor any documents relevant to those averments, there is no unfair lack of notice of the case Batley seeks to prove.

26. I would allow the appeal. I would also reinstate defender's plea to the relevancy (plea in law 1) as the parties agreed that the appropriate disposal is proof before answer.