The Law Commission

Working Paper No. 95

Landlord and Tenant
Privity of Contract and Estate
Duration of Liability of Parties to Leases

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This Working Paper, completed on 27 March 1986, is circulated for comment and criticism only.

It does not represent the final views of the Law Commission.

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CONTENTS

SUMMARY

In this Working Paper, the Law Commission examines the extent of the liabilities of parties to leases. The privity of contract principle means, in the law of landlord and tenant, that the original landlord and the original tenant remain liable to perform their respective covenants in the lease notwithstanding that they have parted with all interest in the property. Similar liabilities are undertaken by assignees of leases who covenant with landlords to comply with lease covenants, and by sureties who guarantee that tenants and assignees will perform their covenants. This contrasts with privity of estate which imposes liability for some, but not all, covenants only during the period that the party owns an interest in the property. The privity of contract principle has been variously criticised as unfair, inconvenient and not giving those who meet the liabilities adequate recourse against the person primarily responsible. This paper, which is issued for consultation, details a number of possible reforms to the privity of contract principle, but provisionally concludes that it should be abrogated. Views are invited both from professional advisers of all disciplines concerned with property, and from the owners and users of all types of property.

LANDLORD AND TENANT

PRIVITY OF CONTRACT AND ESTATE
Duration of Liability of Parties to Leases

PART I INTRODUCTION

1.1 Most people who take a lease of property in England and Wales understand that this effectively gives them temporary ownership of the property during the period for which the lease is granted. They also understand that it involves them in obligations to pay the specified rent and comply with regulations which the lease prescribes, as to the purpose for which and manner in which the property is used, and other related matters. Probably the majority of leases permit the tenant to assign them to someone else, who then takes over the position of tenant. Leases are commonly assigned, frequently more than once. What comes as a considerable surprise, and sometimes a painful shock, to some people who have been tenants is that, even after they have parted with the property, they continue to have a responsibility to ensure that the obligations which they undertook in the lease are fulfilled. The primary responsibility rests with the assignee who has become the tenant, and the original tenant is normally only called upon if the assignee defaults. Nevertheless, the possibility remains that the original tenant can find himself liable for someone else's default many years after he parts with the property. Although the point does not so often arise, landlords

are in the same position. If, having granted a lease of property, they part with the landlord's interest in it, they continue personally to be liable to perform the obligations on their part which were expressed in the lease.

1.2 The liabilities in which this "privity of contract" principle can involve former property owners have, in the last few years, been illustrated in a series of reported cases.[1] The law has not changed, but the greater publicity which it has been given has led to suggestions that reform is required.[2] One view is that the principle should be abrogated, so that no-one has any responsibility in relation to a property in which they have parted with all interest. Others accept the principle as it exists, but advocate some limitation on the liability or a change in its consequences. Yet others believe that the duties of the parties to a lease are the result of a bargain into which they enter freely, and that no change is needed, except possibly action to ensure that people understand the full implications of the contracts they are making.

1.3 The object of this Working Paper is to examine the implications of continuing liability under the privity of contract principle, and to invite the views of all interested parties as to whether any reform is required, and if so what.

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1 Para. 2.18.

2 Another result of increased awareness of the position has been the recent launch of a new insurance policy giving indemnities against some of the liabilities discussed in this paper.

1.4 One of the stated objectives in the Commission's First Programme is the codification of the basic law of landlord and tenant, which was said to be "unduly complicated, anachronistic in many respects and difficult to ascertain".[3] The privity of contract principle is considered by some to be anachronistic, because they feel that it is not in accord with the current requirements of society. If that is the general view, reform of the principle would assist towards the general aim of codifying the law of landlord and tenant, although we regard this study as independent of our major codification work.

1.5 As the first step in our work in this area, we set up a working party to examine the operation of the privity of contract principle and to consider proposals for its reform. This working party consisted of lawyers, surveyors and others with experience of the leasehold property market: a list of members appears in the Appendix to this paper. We have drawn heavily upon the knowledge and experience of the members of the working party, and are most grateful to them for their assistance. We should, however, make clear that the conclusions reached in this Working Paper are those of the Commission. They do not necessarily represent the views of all, or indeed any, of the members of the working party.

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3 First Programme, Item VIII.

1.6 We are also grateful for help we have received in preparing our short summaries of the position in Scotland and Ireland. We received advice on the law and practice in Scotland from Mr. P.A. Dacker, W.S., Mr. J. Campbell, F.R.I.C.S., and Mr. G.C. Neave, F.R.I.C..S., F.S.V.A., and on that in Ireland from Mr. J.F. Buckley, Mr. R. O'Donnell and Professor J.C.W. Wylie.

PART II THE PRESENT LAW

The Basic Rule

2.1 Not only does a lease create a new legal estate, vesting the property in the tenant for a defined period, it also constitutes a contract between the original landlord and the original tenant. This contract imposes obligations, the nature and scope of which are defined by the lease. Normally, the covenants by the landlord with the tenant, and those by the tenant with the landlord, are expressed to continue for the whole of the term granted by the lease.[4] In accordance with the normal rule of the law of contract the parties are bound to perform their obligations in accordance with the terms of this contract. As a matter of law, this is wholly unexceptionable. Accordingly, the lease covenants do continue throughout that period, whether or not the lease (in the case of the tenant) or the reversion (in the case of the landlord) remains vested in the original party to the lease.[5] This is what we refer to as the privity of contract principle. It is possible for a lease to limit the obligation of one or both of the parties, so

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4 Covenants in leases are deemed to be made on behalf of the covenantor and his successors: Law of Property Act 1925, s. 79. This applies "unless a contrary intention is expressed".

5 They can last beyond the original term: para. 3.10.

that it comes to an end if they divest themselves of their interest in the property. Whether or not this is done is a matter of bargain between the parties. There are leases in that form, but they are not common.

2.2 When a tenant assigns his lease,[6] the assignee automatically becomes liable to the landlord, with whom he has "privity of estate", in respect of those covenants which "touch and concern" the property.[7] The rules concerning covenants which ran with the land were condemned 50 years ago as "purely arbitrary and the distinctions, for the most part, quite illogical".[8] Most if not all the covenants commonly found in leases and which directly relate to the property come within this category of those which touch and concern the land. They include the obligations to pay the rent,[9] to repair buildings,[10] to insure them against fire,[11] restrictions on how the property is used,[12] as to ways in which the tenant is

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6 This relates only to a legal lease and not to an equitable one. Certain leases for terms not exceeding three years need not be in writing: Law of Property Act 1925, s. 54(2).

7 Spencer's Case (1583) 5 Co Rep 16a.

8 Grant v. Edmondson [1931] 1 Ch. 1, 28 per Romer LJ.

9 Parker v. Webb (1693) 3 Salk 5.

10 Martyn v. Clue (1852) 18 QB 661.

11 Vernon v. Smith (1821) 5 B & Ald 1.

12 Wilkinson v. Rogers (1863) 9 LT 434.

entitled to dispose of the lease,[13] and covenants relating to improving the premises.[14] Under the general law, the liability of the assignee lasts only so long as he retains the lease. As soon as he assigns it to someone else, there is no longer privity of estate between the first assignee and the landlord, the first assignee has no further liability under the lease.[15] A statutory tenant of residential accommodation is only bound by the "terms and conditions of the original contract of tenancy",[16] which has been held to include only terms binding the tenant as tenant, and not personal obligations such as an agreement to work for a named company.[17]

2.3 When an original landlord, who granted a lease, parts with his interest in the property - i.e. the reversion subject to the lease - his successor is responsible for complying with those obligations in the lease which "have reference to the subject matter of it".[18] This phrase means the same as "touches and

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13 Goldstein v. Sanders [1915] 1 Ch. 549.

14 Hooper v. Clark (1867) LR 2 QB 200.

15 Paul v. Nurse (1828) 8 B & C 486.

16 Rent Act 1977, s. 3. The Rent (Agriculture) Act 1976, Sched. 5, para. 2, is to similar effect.

17 RMR Housing Society Ltd. v. Coombs [1951] 1 KB 486.

18 Law of Property Act 1925, s. 142(1).

concerns the land".[19] A further example is a covenant to supply water to the property.[20] Again, this successor's liability lasts only so long as he is owner of the property. When he passes it on, the liability passes to the next owner.

2.4 Statute already provides an exception to the privity of contract principle, in one special case. On a divorce, the Court has power to order that the tenancy of the matrimonial home be transferred from one spouse to the other. The Act provides that the spouse who transfers does not have any continuing liability under any covenant "having reference to the dwelling house".[21] If, therefore, a transferring spouse had been the original tenant, his or her liability to the landlord under the privity of contract principle is cancelled as soon as the transfer takes effect.

2.5 When an original tenant wishes to dispose of his lease, he generally has the alternative of assigning it, which is an outright disposal, or of subletting the property. If he sublets, he remains a tenant, and fully liable to the original landlord, but will presumably pass on his obligations to the new sub-tenant. There is no contract between the landlord and the subtenant so the privity of contract principle

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19 Breams Property Investment Co Ltd v. Stroulger [1948] 2 KB 1.

20 Jourdain v. Wilson (1821) 4 B & Ald 266.

21 Matrimonial Homes Act 1983, Sch. 1, para. 2(2).

cannot apply.[22] The advantage of this arrangement for the original tenant lies in the fact that he can exercise considerably greater direct control over the sub-tenant than he would have been able to had the same person been an assignee. However, many original tenants may wish, once they have ceased to occupy the building, to have nothing further to do with the property, rather than enter into further arrangements which involve them closely with it. The Royal Commission on Legal Services criticised the proliferation of sublettings, as a factor which complicated conveyancing,[23] and we certainly accept that it would be undesirable to create sub-leases merely as a means of mitigating the consequences of the privity of contract principle. Further, there is no equivalent action which an original landlord can take.

Mortgages

2.6 The privity of contract principle can apply to mortgages in two ways, although neither of them need concern us here. First, traditional mortgages all now take effect as leases.[24] The lender is thus technically a tenant and the privity of contract principle applies. This contrasts with the position of a charge by way of legal mortgage ("legal charge"),

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22 South of England Dairies Ltd v. Baker [1906] 2 Ch. 631.

23 Royal Commission on Legal Services, Final Report (Cmnd. 7648), Annex 21.1, para. 4.

24 Law of Property Act 1925, ss. 85, 86.

which is probably more common now. A legal charge gives to the chargee "the same protection, powers and remedies" as a mortgagee has, but it does not create a mortgage term.[25] Secondly, in some mortgages, the borrower "attorns tenant" of the lender. That is a declaration which makes him a tenant. This is no longer common, although examples are still sometimes reported.[26] Again, privity of contract must apply.

2.7 The considerations which apply to mortgages are very different from those which apply to leases, and no useful comparisons can be made. We understand that mortgages by demise and attornment clauses are now very rare, so that the technical landlord and tenant relationship between lenders and borrowers has all but disappeared. The issues discussed in this paper can therefore have little or no practical relevance to mortgages. We therefore propose totally to exclude mortgages from consideration in this connection,[27] and no provisional recommendation which we make is intended to have any effect on mortgages.

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25 Ibid, s. 87.

26 E.g. Peckham Mutual Building Society v. Register (1980) 42 P & C.R. 186.

27 The Commission is undertaking a separate study of Law of Mortgages: 20th Annual Report, para. 2.34.

Liability of Assignees

2.8 Once a lease has been assigned, the assignee has a direct liability to the then landlord in respect of the tenant's covenants which touch and concern the land under the principle of privity of estate, as explained above.[28] The landlord, however, is able to enforce those covenants either against the current assignee or against the original tenant, and the choice is his. Normally, he looks to the assignee, as the tenant in possession, to perform the covenants. Nevertheless, he is not obliged to seek redress from the assignee first, and can go to the original tenant immediately.

2.9 In almost every case, the first assignee gives the original tenant an indemnity covenant when taking over the lease. The second assignee gives the first assignee a similar covenant, and so on. These indemnity covenants can be, and usually are, implied by statute into assignments or transfers of leases. The assignee agrees to indemnify the assignor against all future payments of rents and agrees to observe and perform the obligations contained in the lease. In the case of unregistered land, the covenant is implied when an assignment for valuable consideration.[29] In the case of registered land, the indemnity is automatically implied into any transfer.[30] An express provision

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28 Para. 2.2.

29 Law of Property Act 1925, s. 77(1)(C), Sch. 2, Pt. IX.

30 Land Registration Act 1925, s. 24(1).

agreed between the parties can exclude the indemnity in either case, or on the other hand can include it in a case which would not otherwise have it. Often, a chain of indemnities builds up as the lease passes from hand to hand. An original tenant called upon to pay may, however, be able to bypass the chain of indemnities and make a direct claim for reimbursement against the current tenant.[31]

2.10 When a landlord has reserved the right in the lease to give prior consent to any assignment, so that the current tenant has to apply for licence to assign, he sometimes insists that the proposed assignee covenants directly with him to observe and perform the tenant's covenants in the lease. Generally, there are two reasons for this. First, the covenant is expressed to be an agreement to comply with the lease terms "throughout the remainder of the term of the lease". This liability extends further than the normal liability of an assignee, because it does not cease if the assignee later assigns the property in his turn to someone else.[32] Secondly, an assignee who enters into a covenant with the landlord undertakes responsibility not only for the covenants which touch and concern the land, but also for any other covenants which may be included in the lease. As soon as the assignee covenants with the landlord there is, necessarily

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31 Para. 2.17.

32 J. Lyons & Co. Ltd. v. Knowles [1943] KB 366.

privity of contract between them. The assignee who agrees to continuing liability effectively agrees to be bound by privity of contract as it is understood between landlords and tenants.

2.11 Even though successors in title of the landlord become liable on the landlord's covenants in the lease while the original landlord remains liable under the privity of contract principle,[33] there is no automatic statutory implied indemnity covenant by the assignee of a reversion. The commonly used general conditions of sale include provision allowing the landlord to require a purchaser to enter into such an indemnity.[34]

Parties Affected

2.12 Although there is no doubt that the privity of contract principle equally affects landlords and

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33 Stuart v. Joy [1904] 1 KB 362. It has recently been suggested that the effect of the Law of Property Act 1925, s. 142, can be to make an original landlord liable, on a covenant which has reference to the subject matter of the lease, directly to an assignee of the lease who only became tenant after the landlord has parted with the reversion: Celsteel Ltd. v. Alton House Holdings Ltd. (No. 2) [1986] 1 All E.R. 598, 604 per Scott J. This would be a considerable extension of liability under the privity of contract principle as it has been generally understood.

34 National Conditions of Sale (20th ed.), conds. 18(3), 19(6); Law Society's General Conditions of Sale (1984 rvsn), cond. 17(4).

tenants, examples of tenants being made liable are more frequently encountered. The primary reason for this is probably that in the majority of leases the tenant undertakes many more obligations than does the landlord. As a result, it is common, and understandable, for those who see problems in the current rules to discuss them in terms of altering or cancelling the tenants' liability. In fairness, it is necessary, in parallel, to consider the liability of landlords.

2.13 In addition to the landlords, tenants and assignees who undertake liability for the lease covenants, guarantors also accept responsibility. It is not uncommon, particularly in respect of leases of business premises, for the landlord to require guarantors for the covenants of the original tenant, and the same thing can occur when there is to be an assignment. We know of no case in which the covenants of a landlord have been guaranteed, and if there are such cases we think they must be rare. The obligations of a guarantor are, normally and unless restricted, co-extenstive with those of the principal debtor. Accordingly, the guarantor of the original tenant remains liable for the whole of the term of the lease.[35] Where an assignee has contracted to accept liability for the performance of the lease covenants

35 Although, apparently, the guarantor's liability is only to the original landlord, unless the benefit of the guarantee covenant is expressly assigned to the landlord's successor: Pinemain Ltd v. Welbeck International Ltd (1984) 272 EG 1166.

for the remainder of the lease term, his guarantors have the same liability . This can result in a large number of individual parties being responsible for the breach of the same covenants.

2.14 The normal rule for all sureties is that if the obligation of the principal debtor is changed, or if the creditor allows him any time or indulgence, the guarantor is released.[36] This effect can be, and very often is, cancelled by the form of a guarantee covenant, in which the guarantor agrees to remain liable notwithstanding such changes. However, a possible difference in the liability of the various guarantors in respect of a single property may be noted. Assume that a lease was originally granted to A, whose covenants were guaranteed by G1. A then assigns the lease to B, whose covenants were guaranteed by G2. B falls into arrear with payments of rent, and the landlord gives him time to pay. That releases G2 from his guarantee, assuming that general rule applies. However, G1 is not released. Despite the similarity of the position of the original tenant with that of a guarantor for the assignee, he is not technically a guarantor,[37] and the time given to B does not release A. As G1 is guaranteeing A's covenant and not B's, the fact that A remains liable means that G1 is also still liable. This is so, even though the covenant which G1 gave did not qualify the normal suretyship rule.

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36 Samuel v. Howarth (1817) 3 Mar 272.

37 Allied London Investments Ltd v. Hambro Life Assurance Ltd (1984) 269 EG 41.

2.15 The death of a party liable under the covenants in a lease does not exonerate him or his estate. To the extent that there is a contingent liablity, which is likely to last for the remainder of the term of the lease, a claim can lie against the deceased's estate. To stop this impeding the winding up of estates, statute allows personal representatives to set aside a fund to meet potential future liabilities, and to distribute the remainder of the estate without further personal liability.[38] This does not cancel any claim which is made, but merely transfers liability, to the extent that the reserved fund proves inadequate, from the personal representatives to the beneficiaries. To take advantage of this, the personal representatives are required to retain "a sufficient fund", and they will normally find it prudent to apply to the court for approval of the amount of the proposed retention.[39] It may sometimes be possible for personal representatives to insure against contingent liabilities, in order to release the assets in the estate. We should be interested to learn how frequently contingent liability under a lease causes delay, difficulty or expense in winding up estates, and whether this is a serious problem in practice.

2.16 A particular case where the effect of a contingent liability needs to be considered is where the party which may become liable is a company. The

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38 Trustee Act 1925, s. 26.

39 RSC O. 85, r. 2.

balance sheet of a company is required to "give a true and fair view of the state of affairs of the company as at the end of the financial year".[40] The accounts must generally comply with statutory requirements which include the need to incorporate a note about any contingent liability.[41] The information that note must give is: the amount or estimated amount of that liability, its legal nature and whether any, and if so what, valuable security the company has provided in that connection.[42] For contingent liabilities under a lease, it is obviously difficult to include any such note which is likely to be at all helpful, except to the extent that it warns anyone reading the accounts that there could in future be a demand for payment. For large companies, liability even for a substantial payment might not be significant enough to prevent the view of the state of the company's affairs in the balance sheet being true and fair. To smaller companies, however, the sums involved could be material. Nevertheless, we understand that it is general accounting practice to ignore these potential liabilities.[43] We should welcome information as to whether that is in fact so, and we invite views on whether this should be regarded as satisfactory, and if not what changes should be made.

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40 Companies Act 1985, s. 228(2).

41 Ibid, Sch. 4, Pt. III, para. 50(2).

42 This does not apply to a small company delivering a modified form of balance sheet: ibid, s. 249, Sch. 8, para. 5.

43 There can be cases in which the company would not know of its contingent liability: para. 3.8.

Recovery of Payments

2.17 The liability of the original party under a lease by virtue of the privity of contract principle will normally mean making a payment of money. This is either because the original obligation is to make a payment, e.g. of rent, or because the obligation will be one which the original party is no longer in a position to perform (e.g. to repair premises to which he no longer has a right of access) and therefore he will become liable to pay damages. In such a case, the original party will wish to know whether he can seek reimbursement. There are two ways in which he may be able to do so. First, if he obtained an indemnity when he parted with the property, he can enforce that covenant. Secondly, the original tenant has a quasi-contractual right of reimbursement against the current tenant in possession.[44] Presumably, the same thing applies between the original landlord and the current owner of the reversion. In both cases, obviously, the value of the right to reimbursement depends upon the continuing solvency of the party which undertook the liability.

Examples

2.18 Some recent reported examples of original tenants made liable after assigning the lease, under

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44 Moule v. Garrett (1872) LR 7 Exch 101.

the operation of the privity of contract principle, may be given -

(a) In 1964, a warehouse was let for 21 years at a rent of £17,000 a year, subject to a review at the end of 14 years. In 1978, the original tenant assigned the lease. The following year, the then landlord and the assignee agreed a revised rent of £40,000 a year. When the assignee failed to pay rent for two quarters, the tenant was found liable to pay the £20,000 then outstanding.[45]

(b) London offices were let in 1972 for a term of just over 28 years. The lease was assigned with the landlord's consent in 1973. The assignee fell into arrears, and the original tenant was liable to pay the amount for which the assignee has defaulted, over £48,000.[46]

(c) In 1973 premises in London were let for 21 years at a rent of £20,000 a year, to be reviewed at the end of the 7th and 14th years. In 1973, the property was assigned with the landlord's permission,

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45 Centrovincial Estates plc v. Bulk Storage Ltd (1983) 46 P & CR 393.

46 Allied London Investments Ltd v. Hambro Life Assurance Ltd, supra.

and in 1976 the landlord agreed to the assignee's carrying out improvements which were otherwise forbidden by the lease. On the first rent review, the rent was fixed by arbitration at a figure which included the value of the improvements, as the rent review clause in that particular lease required. The rent was not paid, and the original tenant was held liable for arrears amounting to £110,000. That liability included payment for the improvement, which was made after the original tenant had parted with the property.[47]

(d) In 1972, business premises in London were let for a period of just under 8 years at a rent of £2,000 a year. In 1979, the landlord gave permission to assign. The lease expired in June 1980. The assignees did not give up possession as they should have done, and as the tenants had covenanted in the lease that they would do. The landlords successfully recovered damages against the original tenants for breach of the covenant to deliver up the premises at the expiry of the lease term and for breaches of the covenants relating to repair and decoration.[48]

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47 Selous Street Properties Ltd v. Oranel Fabrics Ltd (1984) 270 EG 643.

48 Thames Manufacturing Co Ltd v. Perrotts (Nichol & Peyton) Ltd (1984) 50 P & CR 1.

2.19 An older example of a reported decision relating to landlords' liability can be given, although it should be noted that, as a result of this decision, contracts for the sale and purchase of reversions frequently contain provisions to counteract the effect of this case.[49] A five year lease of a lock-up shop was granted in 1958. It contained an option allowing the tenant to renew it for a further term of five years, ie a covenant by the landlords that if the tenant applied they would grant him a new lease. In 1961 the landlords sold their interest in the property, and some months later the tenant gave notice to exercise his option claiming a new lease. For a reason which is not relevant here, the new landlord was not bound to comply with that covenant and to grant the new lease. The original landlords, on the other hand, did have a liability under the covenant, notwithstanding the fact that they no longer had the power to grant a lease of the property.[50]

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49 E.g., National Conditions of Sale (20th ed), cond 18(3); Law Society's General Conditions of Sale, (1984 rvsn), cond. 6(2).

50 Eagon v. Dent [1965] 3 All ER 334.

PART III

CRITICISMS OF THE PRESENT LAW

Matters of Principle

3.1 Some people see the continuing liability of the privity of contract principle as instrinsically unfair. They regard the contractual obligations undertaken in a lease as only properly regulating the terms on which the owner for the time being of a property permits the tenant for the time being to occupy and use it, or as the case may be, to sublet and profit from it. They see no reason why responsibility should last longer than ownership of the particular interest in the property. Furthermore, as the facts seem to indicate that the continuing responsibility in practice falls more on tenants than on landlords, those of this view see the principle as operating in an unfair way, being biased against tenants.

3.2 This view is supported by those who, while not considering it a matter of principle, point to the practical inconveniences which follow from the continuing liability of the original parties to a lease. A person who takes a long lease of residential property, and most flats which are "sold" are leasehold, does not expect to have anything further to do with the property after selling it to someone else. Most people's personal financial resources will not stretch to cover the outgoings of more than one property. The contingent liability is no burden until

a demand is made; at that point, it is likely not only to be unexpected and unwelcome, but also beyond the former tenant's means. The same considerations apply in the case of a small businessman who takes the lease of a shop or other business premises. If he sells up and retires, he may well not expect, nor be able to cope with, demands for claims under the lease which come some time later. Those expressing this view query whether, even if someone considering taking a new lease is fully informed about the effect of the privity of contract principle, this should be a factor which he should be obliged to consider. It militates against the initiative which small businessmen are encouraged to display, by unnecessarily increasing the risks of a new enterprise.

3.3. The contrary view is that the obligations contained in a lease are freely entered into, and if the parties wish to limit their liability in any particular way, they are perfectly at liberty to do so. Freedom of contract is a basic principle of our law, and it should only be modified when it can be demonstrated that it is important or necessary to do so. Most, if not all, the suggested modifications to the present position, which are suggested below as possible reforms,[51] can already be incorporated by negotiation into the bargains struck between landlords and tenants. No change in the law is needed to achieve this.

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51 Part V.

3.4 When a landlord or a tenant sells his interest in a property, the price he receives is one for the property, valued on the basis on the terms on which it is held. The terms of the lease have a direct effect on that value. It is possible to say that the price is adjusted to reflect the effect of the privity of contract principle. Were that principle to be modified or abandoned, prices would presumably be adjusted. For an interim period, there could be those who would receive a windfall profit at the expense of others. After that period, when all property dealings with leases or reversions were done on the basis of any new rules, there would be no unfairness. However, the argument is that as the terms of current contracts take into account the present effect of the privity of contract principle, there is no unfairness now. Difficulty stems from the fact that although a tenant's rent may be marginally lower to compensate for continuing liability, the reduction is not enough to enable him to pay if he faces a demand. Like an insurance premium, the rent adjustment probably reflects the possible risk to all tenants, but unlike a person who pays for an insurance policy the tenant cannot call on a fund built up by payments from all who are at risk.

3.5 The fact that very little advantage is at present taken of the opportunity to modify or abandon the privity of contract principle by the terms of the lease is capable of at least two interpretations. It may be that parties are content with matters as they stand, and do not wish to make any alteration. Or, it could be a reflection of the inequality of bargaining power between landlords and tenants; tenants, as the

parties most likely to benefit from any modification, may either not succeed in their negotiations, or may even not seek change because they regard it as hopeless. We should be interested to receive views on why bargains changing the basis of the privity of contract principle are rare, together with details of any efforts - successful or unsuccessful - to alter it.

Distinctions between Covenants

3.6 A single lease can contain some covenants of which the burden automatically passes to an assignee, by the operation of privity of estate principle,[52] and some which do not. Indeed most leases probably impose obligations of both types. Litigation to distinguish between those covenants which automatically bind successors to the original parties, and those which do not, has thrown up cases from which it is hard to discern the principles which should govern where the dividing line is to be drawn. Some examples may be given. A landlord's covenant to renew a lease runs with the land,[53] but a covenant that the landlord will make a payment to the tenant at the end of the lease, or in default will grant a new lease does not.[54] A

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52 Para. 2.2.

53 Woodall v. Clifton [1905] 2 Ch. 257.

54 Re Hunters' Lease, Giles v. Hutchings [1924] Ch. 124.

covenant not to employ a named person on business premises binds the tenant's successors[55]; a covenant not to employ a particular class of people on the property does not.[56]

3.7 If the effects of a covenant to which privity of estate can apply, and one to which it does not, are very different, it is desirable that it should be simple to decide into which category any particular covenant falls. The present description of the covenants which bind successors - those which "touch and concern" the land or "have reference to the subject matter of the lease"[57] - are not self-explanatory and their interpretation by the courts over the years has left some difficult borderline cases. We should be interested to learn of any difficulties which have arisen from trouble in deciding into which category a particular covenant fell.

Understanding by Laymen

3.8 Some of the criticism levelled at the privity of contract principle stems from the fact that its impact on leases is not understood. It was said in the Court of Appeal, of an assignee's direct covenant, "if

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55 Lewin v. American and Colonial Distributors Ltd. [1945] Ch. 225.

56 Congleton Corporation v. Pattison (1808) 10 East. 130.

57 Paras. 2.2-2.3.

such a clause were not explained to a lay assignee - and it was clear that in this case it was not explained to him - he would be unlikely to appreciate that it rendered him liable for the rent of what might be a long lease".[58] Another judge, in the same case, said that the clause "was a trap for the layman".[59] The clause in question, in a licence to assign, read, "the assignee... covenants directly with the landlord that... the assignee will pay the rent reserved by the said lease on the days and in the manner aforesaid, and perform and observe all the tenant's covenants therein contained". It did not state on the fact of it that the assignee's liability would continue after he had parted with the property, although it had that effect.

3.9 It is an understandable objection that the wording of an obligation in that form does not reveal, even to the careful reader, that responsibility extends for a greater period than anyone unversed in this area of the law might imagine. We think it likely that most assignees, although not all of them, take legal advice, and it could be said that this is a point on which they should be warned and advised in advance. However, there are good reasons why any agreement imposing obligations should make their extent clear without the need to take professional advice. It has also been said to us that many assignees who unwittingly enter into such obligations would not do so if fully

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58 Revlock Properties Ltd v. Dixon [1972] EGD 924, 925 per Sachs LJ.

59 Ibid, p. 926, per Phillimore LJ.

informed, and would not understand the need for them. This may not be a matter upon which firm evidence can be adduced, but we should welcome views as to the degree of misunderstanding of the present position (both in regard to leases and licences to assign), and as to the acceptability of continuing liability to the general public.

Renewals

3.10 Two questions arise as to the impact of the privity of contract principle on cases in which a lease is renewed. It is clear that where a renewal results from the tenant exercising an option granted in one lease to have a new one granted to him, the new lease counts for this purpose as an extension of the old one.[60] That is to say, the privity of contract between the original landlord and the original tenant not only lasts throughout the term of the original lease, but continues until the end of the term granted by the new one. While this may, like the privity of contract principle itself, be regarded as a proper enforcement of the bargain which the parties freely entered into, it has also been subject to the criticism that the extended liabilities can be forced on the original parties. When an option to renew is exercised, it is done by the current tenant, i.e. an assignee if the original tenant has parted with the lease, and the notice is addressed to the current landlord. The

60 Baker v. Merckel [1960] 1 QB 657.

original parties will have nothing to do with the procedure once they have parted with their interest. Indeed, it is likely that they will know nothing about it. Their names will not appear on the new lease.

3.11 Whether this effect extends to new leases granted as a result of the statutory procedure to renew leases of business premises under Part II of the Landlord and Tenant Act 1954[61] is not clear. There seems to be no authority on the point.

3.12 A further question arises in relation to the operation of the 1954 Act: does the privity of contract between the original parties continue during the statutory extension of the initial lease term? The Act provides that "a tenancy to which [it] applies shall not come to an end unless terminated in accordance with [its] provisions".[62] The effect of that provision is not clear. In one case a guarantor's covenant was held not to extend beyond the contractual period.[63] In another, a sub-tenant who had entered into a direct covenant with the head landlord, was liable for a breach of covenant during the statutory extension.[64]

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61 This also applies to assured tenancies of residential property: Housing Act 1980, s. 58(1).

62 Landlord and Tenant Act 1954, s. 24(1).

63 Junction Estates Ltd v. Cope (1974) 27 P & CR 482.

64 GMS Syndicate Ltd v. Gary Elliott Ltd [1982] Ch 1.

3.13 It is certainly desirable that these areas of uncertainty be clarified. There does not seem to be any question of principle involved, unless it is to equate statutory renewal with the effect of the exercise of an option to renew. It is necessary to consider, before framing any new rule, whether one wants to extend or to confine the privity of contract principle.

Extent of Liability

3.14 Recent criticisms of demands made on tenants as a result of the privity of contract principle have concentrated not only on the fact that the sums can be substantial, which when payments have to be made unexpectedly can obviously create difficulty, but also on the fact that the extent of the liability can be varied after the original tenant has parted with the property. The obvious case is that of the rent which is raised on a rent review. It is settled that if an assignee defaults in paying the higher rent, the original tenant is obliged to do so, even though the review took place after he had parted with the lease.[65] Most rent review clauses do not give the original tenant any right to participate in the rent review in those circumstances, and indeed do not even require that he be notified of the amount of the new rent. The first indication he may have of the revised figure is when he receives a demand for payment. The

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65 Centrovincial Estates plc v. Bulk Storage Ltd supra.

justification for making the original tenant liable for rent at the revised rate is that the obligation he entered into in the lease was to pay rent throughout the term, first at the rate stated in the lease, and later at whatever figure might be agreed or determined in accordance with the lease terms. The review therefore merely quantifies the obligation; it does not impose a new duty to pay.[66] The original tenant's feeling of impotence, in having no part in the rent adjustment process, could be exacerbated if the current tenant took no part in it either. In those circumstances, there would be the suspicion that the new rent was unduly inflated, because the landlord has not been opposed. Although there is one reported case of a rent review being completed after the tenant had become insolvent,[67] none has come to our attention where such circumstances have affected a demand under the privity of contract principle. Here again, criticisms could be met by the lease terms allowing the original tenant, and all others who might become liable for future rent payments, to join in the rent review negotiation. We can appreciate, however, the practical difficulties and the expense that this would almost inevitably involve.

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66 It follows that if an assignee voluntarily increases the rent, e.g. in consideration of a consent by the landlord to do something otherwise forbidden by the lease, the original tenant would not be liable for the extra sum.

67 Torminster Properties Ltd v. Green [1983] 1 WLR 676.

3.15 In particular circumstances, the effect of rent review clauses, which have now become almost universal in leases of commercial premises, is open to even greater criticism. The facts in Selous Street Properties v. Oronel Fabrics Ltd outlined above,[68] demonstrate this. There, the original tenant found himself paying rent at a rate which took into account the value of an improvement to the premises which his successor had made. Not only had the original tenant had no benefit from that improvement, he did not know that it had been made, and indeed the lease had forbidden the making of improvements so that he might have supposed he could not incur such a liability.[69]

3.16 The tenant's having to pay rent at a rate he had no part in fixing emphasises one general effect of the privity of contract principle, in its application both to landlords and to tenants: it imposes a responsibility for breaches of covenant which are generally not the result of actions or default of the original party involved, and which they are powerless to prevent. The former landlord of a block of flats has no right to take action to repair lifts or decorate the exterior. The former tenant is not the person who uses the property in a way which causes a nuisance, and cannot prevent it. As matters are now generally arranged, the original parties can pass on any liability they incur to their defaulting successors,

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68 Para. 2.18(c).

69 The landlord gave the assignee express consent to make the improvement, which he was perfectly at liberty to do.

but they have no right to stop the breach of covenant before the enforcement action is, justifiably, taken by the other party to the lease. Some see it as inappropriate that this class of contract should generally impose obligations in circumstances in which it is clear that those with liability have no chance to ensure that the obligations are performed.

Protection of Landlords

3.17 Some people take the view that the effect of the privity of contract principle is unduly to protect landlords. On a breach of covenant by the current tenant the landlord has a range of possible remedies. He may seek to enforce the covenant, he may sue for damages as a result of the breach, in some cases he can distrain for unpaid sums of money, and he can often seek to forfeit the lease. It is unnecessary, the argument proceeds, for him to have the additional security of the possibility of proceeding against the original tenant.

3.18 A distinction is drawn in this argument between the positions of landlords and tenants. First, the position of landlords is considered stronger because they have available the powerful weapon of forfeiture. Secondly, many leases give landlords the power to approve the identity of an incoming tenant before the assignment can be completed. This is so common that it seems likely that any landlord wanting that power of approval would be able to negotiate its inclusion into a new lease being granted. The position is, therefore, that the landlord can influence to whom

the lease is assigned, and the query is why, having approved the proposed assignee, the landlord should also be able to continue to have recourse to the original tenant. It is true that on the occasion of the first assignment of a lease, the original tenant selects the assignee. However, he normally has the right only on the first occasion, and few, if any, leases give the original tenant the right to veto later proposed assignees, although presumably in theory leases could contain such a provision. As far as the reverse case is concerned, we know of no leases in which the tenant is given any right of control at all over a disposition by the landlord of his reversionary interest, and we doubt that any exists.

3.19 Even though landlords commonly have the right to approve a prospective assignee,[70] as things stand the consent to the assignment does not necessarily imply approval of the assignee as the only person who will be responsible for performance of the tenant's covenants. A landlord who understands the nature of the privity of contract principle will consent to a proposed assignment of a lease knowing full well that if the proposed assignee defaults, he will continue to have the possibility of recourse against the original tenant. How far such considerations actually in practice affect a landlord who is entertaining an

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70 Most leases granted in consideration of the payment of a premium now only restrict the tenant's ability to assign during the last few years of the term. Some years ago, wider restrictions in such leases were common, and many of those leases must still be current.

application for licence to assign we do not know, we should be interested to learn. Clearly, if this is a material factor taken into account by landlords, any major modification of the privity of contract principle, or its abrogation, could result in leases proving more difficult to assign. Any apparent benefit to tenants from a reform of that nature could therefore prove illusory.

3.20 It has also been suggested that the effect of the privity of contract principle in these cases should not be looked upon as one of balancing the interests of landlords and of tenants, but rather as a matter of "risk allocation". If an assignee becomes insolvent, he is not going to be able to pay the rent, and the loss of that rent must necessarily fall somewhere. The effect of the present rules is that it will often fall on the original tenant. If the privity of contract principle did not apply, the loss would fall upon the landlord. If any alteration in the rules materially affected the landlord's economic position, the likely effect would be for landlords to seek to compensate by increasing the rents that they charge. This could be seen as a fair response to an increase in the risks of property ownership. We do not know whether the market would in fact react in this way, and although any views must necessarily be speculative, we would welcome comments on the likely effect of any changes in the present arrangements.

3.21 One further effect of the widespread protection of landlords must be mentioned. We have pointed out that a lease may be assigned on a number of

occasions, and each time the prospective assignee may enter into a direct covenant with the landlord to observe and perform the covenants in the lease for the remainder of the lease period. If the covenants by the original tenant and by the assignees are all guaranteed by different sureties, a large number of people become potentially liable to make good any future default in paying the rent. We understand that it is the practice for those advising landlords on recovering arrears of rent in such circumstances to make demands of, and if necessary to take proceedings against, all those who may be liable to pay.[71] This is perfectly proper advice, which we do not criticise. However, it can clearly lead to complicated and expensive disputes and litigation. In one of the cases which we have already mentioned,[72] where admittedly there had not only been assignments but also sub-leases, and the claims were not only for arrears of rent but also for repairing defaults, there were at one time eight separate actions on foot. It is necessary to consider whether the protection of landlords, the satisfactory operation of the property market and freedom of contract justify this complication of disputes, which must impose a greater burden on the courts than would be the case were the number of potential parties reduced.

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71 E.g. Church Commissioners for England v. Nodjoumi (1985) 135 NLJ 1185.

72 Allied London Investments Ltd v. Hambro Life Assurance Ltd, supra.

Enforcing Reimbursement

3.22 A party called upon to make a payment by virtue of the privity of contract principle is not the person primarily liable, and therefore expects to have at least a reasonable opportunity of reimbursement of any payment which he makes. Almost inevitably, the privity of contract principle only operates when the person primarily liable is unable to pay or has great difficulty in paying. The original party to the lease must therefore seek such other security as is available to him, and inevitably he looks to the property as a source of reimbursement. There is no certainty that the interest in question has any net value; a lease at a full rack rent technically has no capital value, and the current landlord or the current tenant may have mortgaged his interest, so that there is no equity value against which an original party can claim. However, assuming that relevant interest in the property is an asset with value, the original landlord or the original tenant who has been called upon to make a payment has no claim against the property, other than as an ordinary creditor. This means he must take proceedings against the defaulting party, obtain judgment and enforce it. The effect therefore is that the landlord has an advantage over other ordinary creditors, by having an alternative source from which he can obtain payment. Yet the person who makes that payment is not subrogated to any special right vested in the landlord, but must take his chance along with other creditors.

3.23 Some original parties who are called upon to make good the defaults of their successors would prefer

not to have some special means of reimbursement, but rather be able to retake their interest in the property. This is of particular concern to an original tenant where the assignee is in default in paying the rent. That default may continue, and each time an instalment of rent falls due the landlord can demand it from the original tenant. If that rent is as much, or more, than the landlord could obtain in the market by reletting the property, he has every incentive to let the original lease run and not to terminate it. In those circumstances, it is in the landlord's best interest not to opt for the remedy of forfeiture, but simply to require regular payment of rent. The original tenant is powerless to prevent this obligation recurring, unless and until he successfully takes proceedings against the assignee and enforces a judgment. In the meantime, the premises generally remain unused, even though the original tenant is paying for them.[73] The injustice is clearly greater if the assignee remains in possession, taking the benefit of the premises without paying the rent. In such a case, what the original tenant wants is some speedy means to resume possession of the lease, in order either to re-occupy the premises and put them to beneficial use, or to be in a position again to assign the lease. Once again, this is a position for which the original tenant can negotiate. Here, it is in the assignment that terms must be inserted, not in the lease. Even though the tenant retains no interest in

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73 Any incentive for property owners to allow buildings to remain empty and unused is likely to be contrary to the national interest that resources should be fully employed.

the property, he can nevertheless reserve a right of re-entry, which could operate if he were called upon to make good any default of the first or subsequent assignee.[74] We understand that this is rarely done in practice, and would be interested in any views as to why this is so. The inequality of bargaining power, which is often given as a reason why the terms of leases appear to be biased in favour of landlords, hardly seems likely to apply in the case of assignors and assignees of leases.

Economic Consequences

3.24 We have already pointed out that the obvious consequence of heavy demands against the original parties under the privity of contract rule is expense to those parties, which, because the sums can be large and the demands unexpected, may prove severely embarrassing. Our attention has been drawn to cases in which businesses have had to incur substantial sums in respect of premises which they had vacated some time beforehand. In effect, therefore, the business had to bear two sets of overheads in respect of their accommodation. That must necessarily have an effect either on the profitability of the business, or on the prices it feels it has to charge for its products.

3.25 We have also mentioned that there are ways of looking at the results of the privity of contract principle which suggest that it is merely one factor in

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74 Shiloh Spinners Ltd v. Harding [1973] AC 691.

calculating market rents, and if it were varied, market factors would adjust the rent. If that argument were accepted, it may be that those who conduct businesses would feel that satisfactory financial planning would be considerably easier for them if the risk of contingent liabilities was effectively commuted and paid for in a slightly higher rent, payable only during their period of occupation of the property.

3.26 We are conscious that a great deal of new property development is now financed by money from investment institutions, and that they also purchase developed properties to hold as investments. Clearly, no adjustment of the rules intended to benefit tenants should be accepted which was likely to reduce the amount of necessary new building or to imperil the savings of the very large number of people who have directly and indirectly invested with those financial institutions. In recent years the property owning institutions have increasingly demanded that they have as nearly as possible a guaranteed return from their propety, based on a "clean" or "clear" rent, i.e. one from which nothing is deducted. If any suggested modification or abrogation of the privity of contract principle would materially affect the terms upon which they invest or the readiness with which they put up money to finance development, these are factors we should want to take into account in considering a reform. We hope therefore that these institutions will tell us how they view the possibilities canvassed in this Working Paper.

PART IV

SCOTLAND AND THE IRISH REPUBLIC

4.1 In assessing the problems in England and Wales, and the options for reform, it may be helpful to consider the rules governing similar situtions in Scotland and the Irish Republic. They are of particular interest because they present contrasts: in Scotland, the privity of contract principle has never applied; in Ireland, the law was originally the same as in England and Wales, but it has been changed by statute which sought to abrogate the principle.

Scotland

4.2 Under the common law of Scotland, a lease is a form of contract creating personal and real rights.[75] When a lease or a reversionary interest is assigned, the former tenant or the former landlord is discharged from further contractual liability. The incoming party automatically assumes the lease obligations, although in practice a new tenant often expressly agrees, in the assignment, to comply with the terms of the lease. Where the tenant's covenants are supported by those of

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75 In certain circumstances it can create an interest in land, but the rules outlined here apply in all cases.

a guarantor, the guarantor's liability is not necessarily automatically discharged when the lease is assigned. Good practice is to obtain an express release from the landlord.

4.3 Whether or not a Scottish lease can be freely assigned depends both on the nature of the lease[76] and on its terms. Most modern leases regulate assignment by the tenant, requiring him to obtain the landlord's consent, possibly to provide guarantors for a company assignee and even imposing an automatic rent increase. A lease may provide that the landlord is not entitled unreasonably to withhold consent.[77]

4.4 The original parties to a lease in Scotland are free to contract in such a way that their liability does continue after they part with their respective interests in the property, as if the privity of contract principle applied.[78] Under the influence of landlords accustomed to English practice, this is becoming a little more common than it once was, but it

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76 Where the tenant has been selected for his personal qualities, particularly if the lease is granted for a short period, it will not be assignable.

77 This is not implied by statute: Scotland has no provision equivalent to the Landlord and Tenant Act 1927, s. 19.

78 The normal way to do this would be by imposing a joint and several liability on the tenant and the assignees. However, a bare statement to that effect is common in Scottish leases, and something more explicit seems to be required.

is still vigorously resisted by most tenants.[79] Because the original parties generally have no continuing liability, assignees do not need to covenant to indemnify their predecessors.[80] If the assignor does remain liable there is normally a right of recourse against the assignee.

4.5 Our impression is that landlords in Scotland are somewhat more cautious in approving proposed assignments by tenants than their counterparts are in England, precisely for the reason that the former tenant is released from liability. Indeed, the practice seems to be[81] to accept that it is reasonable for a landlord to impose conditions to modify this effect in cases in which the incoming tenant's financial standing is weaker than that of the outgoing tenant. So, e.g. the landlord may insist, if his consent is to be forthcoming, that the original tenant guarantee the assignee's covenants, perhaps for the remainder of the term of the lease, for a fixed period of perhaps five years or up to a fixed sum. Or, the landlord may refuse consent to an assignment, but instead permit a subletting.[82] Even if the tenant is

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79 Such resistance is advised in Drafting and Negotiating Commercial Leases in Scotland, Ross and McKichan (1985), paras. 7.3-7.4.

80 For the same reason, there are no indemnity covenants implied by statute.

81 There seems to be no reported authority deciding this.

82 The effect of this is the same as in England and Wales: the original tenant remains liable to the landlord; see para. 2.5.

released, the landlord may seek to improve his position in such ways as by increasing the rent or by requiring the assignee to deposit with him the equivalent of a year's rent.

4.6 Although the absence of the privity of contract principle in Scotland makes landlords wary when considering proposed assignments, the lack of it does not seem to affect property valuation. We understand that valuers in Scotland do not normally differentiate between properties there let on their traditional form of lease and those let on leases expressly incorporating continuing liability of the original parties. The valuations are generally made on the same basis as in England. Similarly, although it might seem logical that the rent for a property let on the basis that the tenant's liability will survive an assignment should be less than for one without that additional security, that does not appear to be the case.

Ireland

4.7 The legal framework of the liabilities of parties to a lease in the Republic of Ireland, which was originally the same as the English common law, has been much altered by the statute. Section 16 of Deasy's Act[83] abrogated the privity of contract

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83 As the Landlord and Tenant Law Amendment Act (Ireland) 1860 is commonly known.

principle, so far as the tenant's liability was concerned, whenever a lease changed hands with the landlord's consent.[84] The position where the lease contains an absolute prohibition against assignment but the landlord nevertheless consents, which might be uncertain under that provision, was settled by later legislation. An absolute prohibition now takes effect as a term which allows the tenant to assign with the landlord's consent, and the landlord is not entitled unreasonably to withhold approval.[85] The position of the tenant who is entitled freely to assign is not entirely clear.[86] A literal reading of the provisions

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84 The Section reads, "From and after any assignment hereafter to be made of the estate or interest of any original tenant in a lease, with the consent of the landlord, testified in manner specified in section 10 [which required written consent]* the landlord so consenting shall be deemed to have released and discharged the said tenant from all actions and remedies at the suit of such landlord, and all persons claiming by, through, or under him, in respect of any future breach of the agreements contained in the lease, but without prejudice to any remedy or right against the assignee of such estate or interest".

* Section 10 was repealed by the Landlord and Tenant (Ground Rents) Act 1967, s. 35(1). It is not clear whether or not this has affected the formalities required by section 16.

85 Landlord and Tenant (Amendment) Act 1980, s. 66, re-enacting Landlord and Tenant Act 1931, s. 56. No consent is needed in the case of a building lease granted for more than 40 years assigned more than seven years before its end, if the landlord is given notice of the assignment within one month.

86 Most residential tenancies, other than of local authority housing, are freely assignable.

suggests that after assigning without consent he remains liable under the privity of contract principle, and this is how the law is generally understood. But if the tenant voluntarily seeks consent, and if the landlord gives it in writing, then the conditions of section 16 are satisfied, and the tenant is released.

4.8 The position of assignees is also dealt with by Deasy's Act. Section 14 provided that an assignee is not to be liable under a lease covenant after he parts with his interest in the property, except to the extent that liability arose while he was owner.[87] This section could be interpreted as invalidating covenants which make the assignee liable over a longer period, to the extent that they purport to have that effect. Nevertheless, we understand that in practice a covenant from an incoming assignee to comply with the provisions of the lease throughout the remainder of the lease term may still be required.

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87 The section reads, "No landlord or tenant, being such by assignment, devise, bequest, or act and operation of law only, shall have the benefit or be liable in respect of the breach of any covenant or contract contained or implied in the lease or other contract of tenancy, otherwise than in respect of such rent as shall have accrued due, and such breaches as shall have occurred or continued subsequent to such assignment, and whilst he shall have continued to be such assignee: Provided, however, that no assignment made by any assignee of the estate or interest of any tenant shall discharge such assignee from his liability to the landlord, unless and until notice in writing of the particulars of such assignment shall have been given to the landlord".

4.9 On the assignment of a lease, the practice is to include a covenant for indemnity by the incoming assignee, as is the case in England.[88] It is accepted, however, that the covenant is not necessary when section 16 of Deasy's Act applies.

4.10 Unfortunately from the point of view of this study and the comparison with the current law and practice of England and Wales, practice in Ireland does not fully take into account these sweeping changes to the common law. Indeed, it is generally assumed that the original parties to a lease do have continuing liability, and the practice is for assignments of leases to contain covenants by the assignee to indemnify the assignor against future breaches of the lease covenants. Further, assignees of leases enter into covenants with landlords worded to make them liable throughout the remainder of the term of the lease, even it they assign it again.

4.11 It is not for us to interpret or comment upon this apparent divergence between the law and the practice in another jurisdiction. We record it merely to inform those who we hope will comment on this working paper, so that they may know that it is not possible to make, and draw conclusions from, the comparisons one might have thought would exist.

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88 In England, the covenant may be express or implied: para. 2.9.

PART V

POSSIBLE REFORMS

Aims of Reform

5.1 The criticisms which have been levelled at the operation of the privity of contract principle may be summarised as follows:

(a) The continuing liability of the original parties is not generally understood, and constitutes a trap for laymen.

(b) A contingent liability necessarily involves inconveniences, because it is not possible to finalise the accounts of those who may subsequently become liable to make payments.

(c) There is no machinery for giving advance warning to those who may be liable for any demand which is likely to be forthcoming.

(d) Performance of the underlying obligations is beyond the control of those who are liable for any default, and therefore they can do little or nothing to avoid their liability.

(e) When demands are made, they can be for substantial sums, and in many circumstances can create real hardship.

(f) There is no effective right of recourse for the reimbursement of those who pay by those who are primarily liable.

(g) Landlords are unduly favoured by the existence of the remedy afforded by the privity of contract principle as their other remedies should be adequate.

(h) There are circumstances in which it is in a landlord's interest to allow an original tenant's liability to continue, rather than to exercise other remedies.

(i) Disputes arising from defaults under leases are unduly complicated by the proliferation of parties against whom remedies exist.

5.2 There is certainly a case for making no change in the law. The existing common law rules have operated for centuries, and although there have been some complaints, their number has been minimal when set against the number of leases granted. Any change in the law is disruptive, and requires users and their advisers to understand and adjust their practices to new rules. This can only be justified if the benefits gained are reasonably substantial. There may well, therefore, be those who feel that no change in the law is needed, and others who feel that no improvement can be achieved which is sufficient to justify reform. To help us to judge the strength of the pressure for reform, and what is likely to be acceptable, we should be interested to hear from those who take the view that there should be none.

5.3 It is reasonable to ask why the law of contract should be varied merely in relation to contracts which are embodied in leases. One justification is that the existence of the privity of estate rule makes these contracts unique. In no other case do obligations to comply with the contract terms spring up on an assignment, supplementing the contractual obligations. Those who would abrogate the privity of contract principle question why a double set of obligations is needed.

5.4 In judging any reform in this field, it is not only necessary to be sure that it materially improves the perceived drawbacks of the present law, it is also necessary to consider how far it achieves other appropriate aims. We suggest that, ideally, the reform should:

(a) Alleviate hardship for all those likely to be affected: original landlords and tenants, assignees, guarantors, and those intested in their estate.

(b) Make leasehold tenure a more satisfactory form of property ownership than it now is.

(c) Avoid reducing the attractiveness of property which is subject to a lease as a form of investment.

(d) Avoid complicating the transfer of leases, or making it more difficult or slower. It would be a natural reaction

of landlords who feel that they will become more dependent on assignees to be more cautious in consenting to assignments. Any marked movement towards additional checks by them could cause material delays in dealing with leasehold property.

5.5 When assessing reforms, it is also necessary to bear in mind the variety of covenants to which the privity of contract principle applies. It is tempting to consider only cases of tenants' failure to pay rent. This is a very common form of breach of covenant, and it is simple to envisage the effects of any new scheme upon it. However, other types of obligation - e.g. insurance, user restrictions, repairs, the supply of services - can all be affected, and the impact of any change on all of them must be taken into account.

5.6 In the remainder of this part of the paper we consider various options for reform, some of which are mutually incompatible. In judging the usefulness and acceptability of any of them, it is necessary to look at it in two ways. First, to what extent does it alleviate or eliminate the criticisms of the present law? Secondly, how far does it achieve the aims of reform?

Minimum Changes

(a) Reverse presumption

5.7 The possible reforms which we first consider are those which involve the least change to the law. One of the complaints against the present law is that it is not understood, so that demands for payment after someone has parted with his interest in the property come as a greater shock than they should do. Those who receive legal advice before entering into a lease might expect to have been warned about the privity of contract principle; but it may be objected that the law of landlord and tenant is so considerable that a complete briefing for a person inexperienced in dealing with leasehold property is not feasible. Be that as it may, the rule could be that privity of contract principle only applied if the lease made it clear that the liability of the original parties continues after they have parted with their interests. The presumption now embodied in the law would therefore be reversed: instead of the privity of contract principle applying unless it is expressly excluded, it would only apply if expressly included. The other rules relating to it could remain identical. If they did it would follow, of course, that the other discontents with the application of the principle would remain.

5.8 How far, in practice, even clear words as to continuing liability appearing on the face of the lease would alert parties is open to question. The discussions between the parties when negotiating are generally confined to the main terms of the lease. The landlord may state that the lease will otherwise be

granted in the standard form he has adopted, and some landlords do not even specify that. The complete lease is frequently lengthy. It is not uncommon for a lease of commercial property to comprise 50-60 pages, and that of a flat may have 20-30 pages. We doubt whether all those who sign these documents read and understand them in detail, particularly bearing in mind the formalised, traditional language in which many are written. It therefore seems likely that no change in the presumption will alter the parties' reliance on the completeness of the preliminary advice they receive. It may be noted that in one of the recent cases, the full extent of the tenant's liability was, unusually, stated.[89] Nevertheless, the tenant sought to dispute liability.

5.9 We have no evidence that those who sign leases do not appreciate that they are entering into legal obligations. We must assume that they realise that they will be bound by the lease terms, whether they read them or not. We do not doubt the importance of the parties understanding their commitments, but it may well be thought equally important that, once someone has signed, others may rely upon the document. The signature is regarded as acceptance of the lease terms, and if the signatory has not taken the opportunity he had to consider, change or reject those terms, the risk is his alone. Nevertheless, this means

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89 "The tenant for itself and its assigns and to the intent that the obligations may continue throughout the term covenants with the landlord.." (emphasis added): Allied London Investments Ltd v. Hambro Life Assurance Ltd.

that the practical result of reversing the presumption could turn out to be that parties to leases remain ignorant of their privity of contract liability, not because (as now) it is not mentioned in the lease, but rather because they do not read the reference to it. If that were to happen, nothing would really be changed.

(b) Shorter leases

5.10 There are also changes in practice by which, by negotiation, the parties could completely avoid the consequences of the privity of contract principle. If such new practices were generally adopted in the property market, contingent liabilities would fade into insignificance. This would be the case, e.g., if only relatively short term leases were granted. There would be fewer assignments of leases, or transfers of reversions during the course of a lease, so there would be less possibility of a demand being made upon an original party who was no longer interested in the property. Further, because only a short period was involved, there would be much less likelihood of escalation in the extent of the liability. Although this change has the attraction that no legislation would be necessary so it could be introduced without delay, there are a number of situations in which it would not be satisfactory. Leases at a low rent sold at a premium need to be for a substantial term in order to justify the payment of the premium and to constitute satisfactory security for a mortgage used to raise the

money to pay the premium.[90] Many tenants, whether paying a ground rent or a rack rent, will want a reasonable lease period, both to guarantee security of tenure and to justify expenditure on the property. Finally, some landlords would only wish to invest in leased property if assured that it will remain let at an acceptable rent for a reasonably long period. Both the cost and the uncertainty of having to relet at an early date would devalue or even disqualify the investment in their estimation. If leases became, as a result, less useful in many circumstances, such a reform would fail to fulfil the aim of making leasehold tenure a more satisfactory form of property ownership.

(c) Break Clauses

5.11 Some of these objections can be met by envisaging leases granted subject to options prematurely to determine ("break clauses"), rather than being originally granted for short periods. However, as both the original landlord and the original tenant have contingent liabilities once they part with their interests in the property, it would be necessary to give each an option. This would introduce an element of insecurity which is likely to be unacceptable, i.e. the landlord's settled investment would be disturbed if the tenant exercised his option, and the tenant's security of tenure would be dissipated by the landlord

90 In the case of residential property, a premium can often only be charged if the lease was originally granted for more than 21 years : Rent Act 1977, s. 127.

exercising his option. Here again, if long leases contained break clauses, tenants might find it impossible to mortgage them to raise a loan for the purchase price. Furthermore, the present legislation giving security of tenure to tenants would in some cases make such break clauses ineffective, both in the case of commercial property,[91] and residential property.[92] Nevertheless, anyone wishing to pursue this option might consider linking it with the suggestion explained below for "buying out" the value of the continuing liability.[93] This would envisage an arrangement whereby exercising the option, and thereby terminating one's continuing liability, would only be possible on making a capital payment to the other party.

(d) Treat commercial and residential property separately

5.12 It may be that some will be of the opinion that reform is only necessary in relation to commercial property or in relation to residential property. The privity of contract principle now affects both. The major impact in each case is probably different. In commercial cases, the majority of lettings seem to be

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91 An agreement is void "in so far as it purports to preclude the tenant from making an application or request under this Part of this Act": Landlord and Tenant Act 1954, s. 38(1).

92 Landlord and Tenant Act 1954, s. 17; Re Henessey's Agreement [1975] Ch. 252.

93 Para. 5.32.

for a full rent, and therefore defaults tend to relate to non-payment of rent. Most leasehold residential property which changes hands is probably let on long lease at a ground rent. Here, the likely liability of the former tenant will relate to dilapidations at the end of the term. However, in both cases other liabilities will arise from time to time. Nevertheless, if it is considered that only one part of the property market needs to be affected by a reform, then to apply it only to that sector would seem, at least superficially, to be a way of minimising the inconvenience caused.

5.13 Our preliminary view is that to apply any reform only to certain types of property, or property put to certain uses, would not be satisfactory. Other landlord and tenant rules are divided in this way, and this has given rise to much litigation to determine into which category the particular letting or property falls.[94] Unfortunately, no universal distinction has yet been drawn, and therefore it is likely that a new definition would be required which would give rise to more classification disputes. Among the obvious problems are properties of which the use is changed such as the oast house or railway station which is converted into a dwelling, and properties which are put to both residential and business use at the same time.[95] Furthermore, to divide properties in this way,

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94 E.g. Lewis v. Wildcrest Ltd [1978] 1 WLR 1107; Lee-Verhulst (Investments) Ltd v. Harwood Trust [1973] 1 QB 204.

95 E.g., Cheryl Investments Ltd v. Saldanha; Royal Life Savings Society v. Page [1978] 1 WLR 1329.

on the basis that a change in the law is being minimised, is in fact to produce a position where there are two parallel sets of rules rather than one single set. That necessarily complicates the law, and stands in the way of its being easily understood.

Rights of Payers

(e) Notice of Default

5.14 One of the discontents expressed by those who find themselves liable under the privity of contract principle is that they knew nothing about the facts which gave rise to the claim until they received it, even though they could perfectly well have been informed. This is, of course, not merely a matter of idle curiosity; as soon as they learned of the default, they might have been able to take steps to protect their own position by proceedings or otherwise, and might thereby have minimised their eventual liability. In a straightforward case, it would be simple to have a rule that the original tenant should be promptly informed if, e.g., the assignee fails to pay an instalment of rent promptly. This might enable the original tenant to pay the landlord and to start proceedings for reimbursement against the tenant in possession so that his liability was not unduly extended. As a sanction, to ensure that information was given when it should have been given, the amount the landlord was entitled to recover against the original tenant could be limited to arrears accruing within (say) the six months prior to the demand being made.

5.15 Three difficulties are apparent in this suggestion. First, as we have already mentioned, the circumstances can be such that a number of people are all liable on the default of the current tenant. Presumably, all would have to be notified if the landlord wished to maintain his rights to proceed against them all.[96] This would involve what might become a not inconsiderable administrative burden, not because the notices had finally to be given but rather because the landlord would have to maintain records of the current addresses of all the people who might be liable. Presumably, those with a liability would have the obligation to inform the landlord of any change of address, and would not escape liability if the landlord gave notice to an out of date address merely because they had not notified the change. On the other hand, as a corollary, it would be necessary whenever the landlord moved or the reversion changed hands for notice to be given to those who could be made liable on the tenant's default.[97] If this were not done, the original tenant and later assignees would not effectively be able to reject their own changes of address.

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96 Any requirement of notification would run counter to the spirit of the Law Commission's recommendation that the present procedure for forfeiting leases be simplified by abolishing the need for preliminary notices in most cases: Forfeiture of Tenancies (Law Com. No. 142), paras. 8.29-8.32.

97 This would be a considerable extension of the landlord's present statutory duty to notify the tenant of a dwelling when the reversion changes hands: Landlord and Tenant Act 1985, s. 3.

5.16 The second difficulty arises with the operation of the indemnity covenant which an assignee gives an assignor. Assume A assigns a lease to B, B covenants to indemnify A against future defaults and also gives a direct covenants to the landlord, B later assigns to C. C does not pay the rent. The landlord promptly notifies A of the default, but says nothing to B. The landlord recovers the outstanding rent from A having forgone his right to proceed against B. However, A can still claim indemnity against B. The rule requiring preliminary notice could also require A to give notice to B as soon as A received notice from the landlords. The full ramifications of such a rule would obviously result in a proliferation of warning notices, and a considerable amount of precautionary record keeping.

5.17 A more substantial objection lies in the way in which the rule would apply to obligations other than payment or rent. Take, for example, a repairing covenant. It might well be reasonable for the landlord not to take proceedings for a minor breach of covenant, and indeed the provisions of the Leasehold Property (Repairs) Act 1938 are intended to discourage that. Nevertheless, a want of repair is normally progressive. Would the landlord have to notify the original tenant, in order to ensure that he did not lose his right against the original tenant, as soon as he saw some deterioration? and would there have to be further notifications every time other defects were noted? Many leases place repairing obligations on the landlord, and we have exactly the same misgivings about this solution in relation to notices which tenants have to give to a former landlord when complaining to their present landlord of matters in need of repair.

(f) Consent to assignments

5.18 To meet the point that an original tenant is effectively underwriting the performance of all his successors, while he only has the opportunity to choose the first of them, he could be given the right to give prior approval to later assignments. In the case of an assignment of the lease, this would mean that an assignee wishing further to assign might be faced with the necessity of obtaining licence to assign both from the landlord and from the first tenant. This is also something which the parties could at present achieve by agreement, although we understand that they seldom if ever do.

5.19 We see serious objections to this suggestion in its likely effect upon conveyancing. The procedure for obtaining licences to assign from landlords is already widely criticised because of the time it often takes and because of the cost involved.[98] To impose the need for two licences in place of one can only exacerbate the problem. If one went further, and permitted intermediate assignees who had entered into a direct covenant with the landlord to observe the tenant's covenants in the lease also to give consent, the potential for delays and expense would be wholly disproportionate. As far as transfers by the landlord are concerned, we doubt whether any proposal that the

98 See, e.g., Covenants Restricting Dispositions, Alterations and Change of User (Law Com. No. 141), para. 8.57.

conveyance of the reversion should be subject to the consent of a former owner of it would be acceptable. Possibly, such a restriction would be contrary to the essential nature of freehold ownership, and in derogation of the grant constituted by the conveyance from the original landlord to his successor.

(g) Participation in rent reviews

5.20 The effect of rent review clauses on the liability of an original tenant, increasing the rate of rent for which he is responsible after he has parted with the lease, can be seen as unsatisfactory. The apparently unfair effect - liability without the opportunity to influence its amount - could be changed by giving the original tenant the right to participate in the review process. This would not change the basis of his liability, nor necessarily the extent of it, but he would not be able to complain that he had not participated in fixing the new rate of rent. The landlord need not be obliged to invite the original tenant to participate in the review process, but the new rate could be made to bind the original tenant only if he had been asked.

5.21 Again, we see drawbacks in this proposal. First, there may be a number of people who potentially are liable to pay rent at the new rate, and the same rule would presumably apply to all of them. If that were the case, rent review procedures, already often lengthy, would become very complicated and costly. This is already the case with some enforcement proceedings when rent is not paid; but rent reviews

are probably more common occurring regularly under leases where no proceedings are ever necessary. It seems likely that the cost and complication of multipartite review procedures would be greater even than those now involved in the rent enforcement procedures, and the latter would also continue. Secondly, as a subsidiary point, it would be necessary to consider whether an original tenant who had not been invited to participate in one rent review could be given notice of a subsequent review so that he was not permanently excused from paying rent at a higher rate by the first omission. This is of particular concern in relation to "upwards only" reviews, where the new rent is whichever is the greater of the old rent or the rent determined under the review procedure. The new rent in such a case can, in effect, be determined at the previous review.

(h) Suretyship rules

5.22 The unusual, but seemingly unfair, circumstances of the Selous Street Properties Ltd case,[99] where the original tenant became bound to pay rent based in part on the value of an improvement of which he knew nothing and from which he had taken no benefit, could be avoided by equating the position of the original tenant and the original landlord with that of surety. A variation in the terms of the primary obligation would then release them from liability.[100] It cannot necessarily be assumed that a variation is

99 Para. 2.17(c).

100 Samuel v. Howarth (1817) 3 Mar 272.

undesirable. For the landlord to consent to an improvement - as in the Selous case - will generally benefit the national stock of buildings. A landlord who recognised that to give consent would prejudice his position, by releasing the original tenant, might be deterred from doing so. Such a change would not, therefore, be wholly beneficial. However, as explained, it is common for guarantors to be called upon to contract out of this right[101] and it is therefore conceivable if not probable that the same thing would happen on a regular basis if this change in the law was made. The change, although seemingly fair, would thus be rendered nugatory.

Modifying Liability

(i) Financial limit

5.23 One of the objections to the contingent liability of original parties to a lease is that it is impossible to forecast the amount of any claim, and there is no maximum. This is a perfectly normal and proper result of the form of contract now entered into, but the inconveniences are obvious. They could be alleviated by some scheme directly aimed at imposing a maximum liability. Alternatively, the time during which claims might be made could be limited; the practical effect of that would not only be to reduce the period of risk, but also to limit the impact of

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101 For an example of such a clause see Encyclopaedia of Forms and Precedents (4th ed.), vol. 12, p. 1242.

rent reviews, inflation and the cumulative effect of continuing breaches of covenant in increasing the liability. In considering any of these suggestions, it must be borne in mind that a reduction in the liability of one party necessarily cuts down the entitlement of the other. Thus, an improvement in the position of tenants is necessarily only achieved at the expense of landlords.

5.24 If a financial ceiling were placed upon the liability of original parties, it would necessarily have to have some direct relation to the terms of the lease or the property involved. We do not consider that any single cash figure, even if adjusted periodically, could possibly achieve the desired object with any degree of fairness. A financial limit which would be of use to the landlord or tenant of a residential flat or a small lock-up shop would unreasonably curtail the liability of a party to the lease of a large factory or a block of offices. Conversely, a limit which was reasonable for those larger properties would effectively mean that the liability of those concerned with smaller properties remained unlimited. One method of gearing the limit to the value of the property would be to link it to the rateable value of the property. This has been done, on a basis adjusted periodically, in respect of compensation payable to the tenants of business premises who are deprived of their rights to renew their leases.[102] However, the repeated efforts to

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102 Landlord and Tenant Act 1954, s. 37, as amended by the Local Government, Planning and Land Act 1980.

scrap at least part of the rating system indicates that this may not be a satisfactory scheme of long term reform.

5.25 An alternative is to link the limit to the rent of the property, e.g. to make the limit a specified multiple of the annual rent. This scheme involves other difficulties. First, where a rack rent is paid, should the multiple be applied to the last level of rent which the original tenant paid (which would seem to be fair to the tenant), or to the current rent which might have been increased following one or more rent reviews (which would be fair to the landlord)? Some rent rises on review are so dramatic that to calculate the limit of liability by reference to the old rent would be quite unrealistic from the landlord's point of view. Yet to link the limit to the rent as reviewed, would do nothing to meet the objections which original tenants raise to finding their liability geared to a rent over which they had no control. Secondly, when a long lease is granted at a premium and reserves a ground rent, to apply a multiple which was appropriate to rack rents to the ground rent would not be realistic. A separate multiple could be prescribed for such cases, but there would be difficulty in identifying in marginal cases, whether or not a rent was a ground rent or a rack rent.[103] Certainly, arrears of ground rent are rarely a problem,

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103 Again, current legislation has tended to differentiate by making a comparison with rateable value: e.g. Rent Act 1977, s. 5.

but claims for dilapidations at the end of such a lease can amount to a considerable sum. There is no logical connection between the fair and likely amount of liability for dilapidations and the ground rent.

(j) Time Limit

5.26 An alternative approach to limiting the liability of the original parties is to impose a single time limit on it - or possibly a time limit which varies with the length of the lease term - running from the date on which they ceased to have an interest in the property. A contingent liability extending for the bulk of the term of a lease granted for 25, 35 or 99 years, or even longer, can be seen as a considerable burden. A persuasive case can be made for a time limit when considered in relation to proceedings against the original tenant in relation to arrears of rent. It is fair for the landlord to be assured that the assignee is a satisfactory tenant who both can and does pay his rent promptly and regularly. But once the assignee has proved himself, fairness may demand that the original tenant can withdraw. Landlords normally take up references for prospective assignees, but they are no substitute for experience in practice once the tenant has moved in. Accordingly during a reasonable trial period the liability of the original tenant could remain, effectively providing the landlord with a guarantee. This should prevent any change in the law making landlords more cautious in approving proposed assignments, avoiding the result that the conveyancing process might be slowed. The period of continuing liability of the tenant should ideally extend beyond the date on which the next rent review occurs, assuming

that the lease provides for one, so that the landlord knows whether the assignee will be able to meet any increased obligations. If an assignee proved unsatisfactory within the "trial period" the landlord would be able both to forfeit the lease, and obtain payment of arrears from the original tenant.

5.27 The logic of this proposal does not extend to other situations. Once the original tenant has been released, the landlord has no special protection when the lease is further assigned. Or, take the default in observing a tenant's repairing covenant, rather than rent arrears: in that case, the position is radically changed. Because the policy of the Leasehold Property (Repairs) Act 1938 is to delay most dilapidations claims until near or at the end of the lease, a five year period of continuing liability, say, ten years before the lease expired would be of no help to the landlord. The original tenant would have ceased to be liable before the landlord made any claim. Again, as landlords generally have no obligation to make regular payments to the tenant, and the tenant does not have a once and for all enforcement remedy equivalent to forfeiture by the landlord,[104] there seem to be no particular arguments to recommend the "trial period" approach to original tenants. Even if a new landlord proves unsatisfactory, and does not perform the landlord's covenants in the lease, the tenant cannot take decisive action during a specified brief period.

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104 Forfeiture of Tenancies (Law Com. No. 142) recommends the introduction of a tenant's termination order which would provide such a remedy.

(k) Overlap liability after every assignment

5.28 A variation on the previous suggestion would apply the same principle of limited liability following every assignment not merely the first. The original tenant's liability would extend until, say, five years after the first assignment, but no longer. In addition, after every assignment of the lease the assignor's liability would continue for a further five years. The same thing would apply to landlords on each occasion that the privity interest changed hands. The effect of this on the assignment of a lease would be to give the landlord added security while the new tenant proved his worth. Tenants would have the equivalent benefit on a change of landlord.

5.29 This possibility standardises the effect of every dealing with either the landlord's or the tenant's interest in a property. However, it does so at the cost of extending the liability of many of those involved. When an assignee, whether of the lease or the reversion, parts with the property he now has no further liability, unless he has entered into a special contract. Were this suggestion to be adopted, some continuing liability would be imposed, albeit for a limited period, where none now exists. We doubt whether this would be generally acceptable; many would consider it a retrograde step.

(l) Limitation period

5.30 An alternative time limitation would merely be to require any claim to be made against an original

party within a certain time after the default became apparent, if it was to be made at all. This would effectively be the imposition of a strict limitation period on this type of claim. The reasons for imposing a limit are much the same as those in favour of a requirement for preliminary notification. It gives the tenant a reasonable degree of certainty without depriving the landlord of anything provided he acts diligently. Indeed, this proposal might be regarded as a variant of that previous one.[105]

5.31 A simple time limit on demands and proceedings against original parties would not have the administrative drawbacks of the notice requirement.[106] It would bring the positive advantage, in the case of arrears of rent, that the landlord would be unable beyond a certain point to allow the arrears to build up, in the knowledge that he is merely increasing his claim against the original tenant. However, all limitation rules impose pressure and sometimes hardship upon claimants whose time for action is restricted. We do not think that a limitation period which is more stringent than usual should be imposed in a particular case unless there are particularly strong arguments in support, and we do not believe that this is such a case.

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105 Para. 5.17

106 Para. 5.18.

(m) Purchase release

5.32 A further suggestion put to us was that any party who wished to escape his continuing liability when he parted with his interest in the property should be entitled to do so on making a capital payment to the other party. He would, in effect, buy his release from liability. Such an arrangement could be made at present under a contract between the parties, but we believe that it is rarely or never done. A major attraction of this suggestion is that it leaves the economic balance between the landlord and the tenant where it now is. Also, there would be no compulsion upon the original party to exercise the option to buy out his liability, although the continuing party would have to accept the arrangement if the scheme were to work. It does permit a distinction to be drawn between those for whom a continuing contingent liability is a real concern, and those for whom it poses no difficulty. The former could exercise their purchase option to obtain a permanent release; the latter would not have to. Nevertheless, we must add that we suspect that those whom the continuing liability worries, because they fear they would not have the means with which to pay a demand, might well be those who would not feel able to pay a capital sum to obtain their release.

5.33 It has been suggested to us that it would be possible for valuers to calculate and negotiate a proper sum for buying out continuing liability in any particular case. However, we feel that if this proposal is to be workable it should be sufficiently simple to operate automatically in every case, without

the delay and expense which would necessarily be involved in individual negotiations whenever an option were exercised. If an escape from continuing liability were regarded as something for which the procedure was in itself lengthy and costly, that would be a disincentive to those who might otherwise wish to benefit from exercising their option. Accordingly, we should welcome suggestions from any protagonist of this scheme for some satisfactory formula by which the consideration for buying out continuing liability could be calculated. Again, arrangements should be made not only to enable the tenant to escape continuing liability, but for the same thing to apply to landlords.

Consequences of Liability

(n) Statutory charge

5.34 We now look at suggestions concerned with the consequences of people being made liable under the privity of contract principle. Whether the extent of the liability remains as it is, or is limited under one or more of the foregoing suggestions, there is still the dissatisfaction felt by those made liable that they have insufficient recourse to reimburse themselves. One way in which this could be tackled would be to impose a statutory charge in favour of the person making the payment on the relevant interest in the property. So, if the original tenant were called upon to pay, he would have a charge for the amount he had had to pay against the lease. If the payment were made by the original landlord, his charge would be on the reversion. Therefore, the person who had been made

liable and paid would be in the position of a mortgagee, with security for what was the equivalent of a loan to, as the case may be, the current landlord or the current tenant.

5.35 Any statutory charge must necessarily suffer from certain drawbacks. It can only be of value to the extent that there is equity value in the property. The process of realising a mortgage security, particularly where the deeds are not in the mortgagee's hands and the charge may not be a first charge, can be a lengthy one. However, a mortgagee does have the option of going into possession which would sometimes be advantageous. Again, consideration would have to be given to the need to register such charges to alert third parties dealing with respective interests in the property. The existing machinery for registering changes could be used without difficulty.[107] Finally, it should be noted, in the case of charges in favour of the original tenant, that a charge on a lease is necessarily at risk from any action by the landlord to forfeit the lease.[108]

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107 By registering a caution against registered land : Land Registration Act 1925, s. 54; or, for unregistered land, by registering a puisne mortgage: Land Charges Act 1972, s. 2(4).

108 Presumably he would have the right to apply for relief against forfeiture: Law of Property Act 1925, s. 146(4).

(o) Right of re-entry or reassignment

5.36 An original tenant called upon to make a payment under the privity of contract principle could be given a statutory right of re-entry. This would enable him to take back possession of the property on the terms of the lease. We have noted that this is something for which it is already possible for him to contract.[109] If given by statute, however, the right would arise automatically. As an alternative to a right of re-entry, the tenant could have a right to require that the lease be reassigned to him. The effect would be similar, but as matters stand the stamp duty and registration consequences might be different. On the other hand, neither re-entry nor reassignment is probably an appropriate remedy in the case of the original landlord, although it is possible for a freehold estate to be subject to a right of re-entry.[110]

5.37 For the original tenant, this type of remedy could well be satisfactory. It would enable him to ensure that no further liability accrued; he would be able to re-use the premises, or assign them again. However, the benefit should not be exaggerated. In practice, it is likely that the current tenant would have attempted to assign the lease, and would have failed to do so. The original tenant might well be no

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109 Para. 3.23.

110 E.g., for the enforcement of payment of the rentcharge: Law of Property Act 1925, s. 121(3).

more successful, although he might judge it to be to his advantage to pay an assignee to take the lease off his hands,[111] something which the assignee might not have had the resources to do. For others who might have to pay upon the current tenants default, e.g. guarantors, a right of entry is unlikely to be satisfactory.

5.38 The simplicity of this remedy may also be deceptive. It is possible to imagine circumstances in which to exercise it would be oppressive. If there had been a relatively minor default in paying the rent, could the current tenant be completely deprived of the premises, which might be of considerable value, if he did not reimburse the original tenant before the latter took action to re-enter? It seems likely that some modification, similar to relief against forfeiture, would be necessary either by statute or by the exercise of an equitable jurisdiction. Judged by the example of relief against forfeiture, this could involve much litigation.

(p) Just and Equitable Relief

5.39 The view of some is that the circumstances in which the privity of contract principle applies vary so much that no single change in the law can make it just. They see some cases in which they feel that it should not involve any liability, but others where they would

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111 A payment known as a "reverse premium."

want no change in the present rules. However, they do not believe that there is any way to define the cases when the application of the principle should be modified. This leads to the proposal that the court should be given the power to give relief where, and to the extent that, it seems just and equitable to do so.

5.40 To give any such discretion introduces a considerable degree of uncertainty into the law. This remains so even if the court is given guidance as to the principles on which the discretion should be exercised. The difficulty in defining the cases in which any change in the law should be made must be reflected in a difficulty in defining the basis for the exercise of a relieving jurisdiction. Presumably, hardship would be a criterion. However, in any case concerning a contract, to relieve one party's hardship almost inevitably imposes hardship on the other. Where a bargain has been freely entered into, is that acceptable? It has also been pointed out that major companies are at a considerable disadvantage in such cases, as it is generally assumed that even if a rule seems to operate against them capriciously or partially, their economic strength prevents their suffering hardship. Is it right that some bodies should effectively be excluded from the benefit of a discretionary relief? We consider that injecting an element of uncertainty into an area of the law where the rules are now clear needs to be justified by compelling reasons. Inevitably, the number of disputes would rise, because parties would hope to be able to persuade the court to exercise its jurisdiction in their favour. The costs of that result, both to the public purse and to parties' private resources, seems unlikely to justify the benefit of introducing this flexibility.

Summary

5.41 We recognise, and would emphasise, that some of the foregoing suggestions for reform are mutually incompatible, while others could be introduced to provide a cumulative effect. We would urge those who comment to us to take account of this, in considering which if any options they would advocate.

5.42 For convenience, we list below the options for reform examined earlier in this part of the Paper:

(a) Reverse presumption (para. 5.7);

(b) Shorter leases (para. 5.10);

(c) Break clauses (para. 5.11);

(d) Treat commercial and residential property separately (para. 5.12);

(e) Notice of default (para. 5.14);

(f) Consent to assignments (para. 5.18);

(g) Participation in rent reviews (para. 5.20);

(h) Suretyship rules (para. 5.22);

(i) Financial limit (para. 5.23);

(j) Time limit (para. 5.26);

(k) Overlap liability after every assignment (para. 5.28);

(l) Limitation period (para. 5.30);

(m) Purchase release (para. 5.32);

(n) Statutory charge (para. 5.34);

(o) Right of re-entry or reassignment (para. 5.36);

(p) Just and equitable relief (para. 5.39).

PART VI

ABROGATION OF PRIVITY OF CONTRACT PRINCIPLE

Provisional Conclusion

6.1 On the information we have, it seems that the various difficulties caused by the application of the privity of contract principle call for some reform. However, this conclusion is necessarily provisional because we have no evidence at present as to the scale of discontent with the law as it now is. It will therefore be of value to us to learn, in responses to this paper, not only of criticisms of the law, but also of the number of people affected and the number of occasions when difficulty is experienced.

6.2 Assuming that reform is required, it seems clear that none of the possible reforms examined in Part V of this paper meet all the criticisms of the present law. While the partial solutions which some of them offer could prove helpful, it is also likely that tinkering with the law in that way would not simplify it. We have therefore formed the tentative conclusion that the proper course to recommend is the total abrogation of the privity of contract principle, at least to the extent that it relates to covenants which bind successors in title. This would mean that

those covenants in a lease would be interpreted as only binding the parties while they continue to own their respective interests in the property. Covenants in licences to assign would be construed in the same way.

6.3 We should be interested to receive views upon the likely impact on the actions of landlords of abrogating the privity of contract principle. It is important to consider whether this would prejudice tenants, either because landlords would seek to grant leases which did not permit any assignment, or because they would be more cautious in considering applications for licences to assign. At present there are very few restrictions in law which prevent a landlord from granting a non-assignable lease.[113] However, we think that market factors are likely to restrain any unacceptable increase in limitations on tenants' rights to assign. A tenant negotiating a new lease would probably reject an absolute covenant against an assignment if he was paying a capital sum for the lease or if the proposed term was of any appreciable length. Further, such a restriction would probably reduce the amount both of the rent obtainable when the lease was

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113 E.g., Agricultural Holdings Act 1948 s. 5(4), Schedule 1 para. 10; Agricultural Holdings Act 1984, s. 10(1), Schedule 3 para. 3(3). The Commission has recommended that in future landlords should only be able to impose absolute powers against assignment in a limited number of exceptional cases: Covenants Restricting Dispositions, Alterations and Changes of User (Law Com. No. 141), paras. 7.4, 7.7-7.44.

granted and of any rent fixed on a subsequent rent review. Necessarily, the effect of any change must be speculative, but we should welcome comments on the likely results.

6.4 We are concerned at the possibilities that leases will become less marketable, and that conveyancing delays will increase, if the abrogation of the privity of contract principle makes landlords enquire more closely before granting licences to assign. We accept that without the privity of contract liability, landlords would have to rely more heavily on assignees. However, our impression is that at the moment when an application for licence to assign is considered, little if any weight is placed on the original tenant's liability. Landlords do not, we believe, give consent to an assignment to an assignee who may prove unreliable, merely because the original tenant's ability to perform the lease covenants is undoubted. The practice seems to be to consider the assignee's position independently.[114] Indeed, provided the assignees's credit-worthiness is adequate, a

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114 In a recent case, Ponderosa International Development Inc. v. Pengap Securities (Bristol) Ltd. (1985) 277 EG 1252, Warner J accepted evidence "that it is a widely held view in the property market, and in particular among investors, that, after an assignment of a lease, the identity of the original lessee is of no interest" (p. 1255). He held that notwithstanding the liability under the privity of contract principle, "the fact is that [the landlord] has to live in the real world and to take the market as it finds it, not as lawyers might wish it to be" (p. 1256).

landlord who is not entitled unreasonably to withhold consent would not be able to do so, contrary to the practice in Scotland, merely because the assignee's covenant is not as strong as that of the original tenant.[115] Accordingly, it seems to us likely that fears of consequential difficulties of tenants who are seeking to assign would probably be unfounded. Here again, we hope that those who could be affected will tell us any how new rules are likely to operate in practice.

6.5 It is clear that such an abrogation of the privity of contract principle would necessarily involve certain other alterations to the rules affecting leases, and there are consequential matters for consideration. These are examined later in this Part of this paper. We are anxious to learn whether or not our provisional conclusion attracts support, and we hope that those who comment upon it will do so in the light of the subsidiary points which follow.

Personal Covenants

6.6 Abrogating the privity of contract principle as it affects all covenants which now bind successors, by virtue of privity of estate, still leaves the question whether anything should be done about other covenants in leases. We have identified three

115 International Drilling Fluids Ltd. v. Louisville Investments Uxbridge Ltd. [1986] 1 All ER 321, 326.

possibilities: leave matters as they are; reform the distinction between the covenants which bind successors and those which do not, but otherwise do nothing; or make all lease covenants bind successors and eliminate all continuing liability for parties who have parted with their interests. We shall examine each in turn.

6.7 Before we do so, there is a preliminary matter on which we should appreciate help. How common are purely personal obligations in leases, or in contractual arrangements made as part of the bargain for the grant of a lease? It is easy to illustrate what is meant by a purely personal covenant not intended to bind a successor. An example is a tenant's covenant that he will work for a named company. But how common are such obligations? Obviously, evidence as to their frequency must affect any judgment about the proper provision to make for them.

(a) No reform

6.8 The strongest arguments for leaving as they are the rules relating to covenants which do not run with the lease and the reversion is that they have not given rise to difficulties, they are known and familiar, and any change cannot clearly be identified as an improvement. However, there are certainly some covenants, which do not at present bind successors, which become inappropriate, once there has been an assignment. Some then become impossible for the original covenanting party to perform. If the privity of contract principle were to be abrogated, so that only those currently concerned would be liable to

perform covenants which relate to the property, logic might suggest that liability to perform personal covenants should cease as soon as performance was impossible. We doubt whether there should be statutory intervention to that effect. Not only can the parties already agree to the liability so ending if they want to, but such a provision would permit anyone to escape from liability, without in this case substituting the liability of anyone else, simply by assigning.

(b) Change definition

6.9 Even if the present principles of liability are not disturbed, it may be desirable to seek to redefine the class of covenants to which privity of estate applies. We have not yet attempted to do this in any detail. Tentatively, we think a good approach would be to define those covenants to which privity of estate does not apply, rather than the reverse. The principle could be that covenants which are both personal in nature and collateral to the purpose of the lease transaction should not be affected by privity of estate. We foresee that it will be difficult, and might even be impossible, to propose a new definition which is helpful, sufficiently flexible to cover the great variety of obligations encountered in leases and an improvement on the present position. We shall attempt this if it is generally thought that it would be helpful. We therefore ask those who consider that the distinction between privity of contract and privity of estate should be maintained for this purpose, whether they feel that the definition should be altered, and if so, on what general principles any new definition should be based.

(c) Assignees to assume liability

6.10 An abrogation of the continuing liability of the original parties to the lease could be made to extend to all lease covenants, not merely to those to which privity of estate applies.[116] That would mean that the current landlord and the current tenant would be liable, and the only ones liable, to perform all the lease covenants - both those directly affecting the property and personal ones. The underlying justification for such a proposal is that a lease is granted and accepted in consideration of the other party undertaking a range of obligations. Those obligations constitute a package, and anyone taking over an interest in the property should be prepared to take on the whole of that package, without differentiating between personal and other covenants. It is true that an assignee might be incapable of performing some covenants, which rely on personal performance by an original party exercising a unique talent. However, the present privity of contract principle can impose a liability which after assignment, the original party is incapable of

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116 It has been proposed that this rule be formally adopted in Northern Ireland, where it is already the practice: Land Law Working Group, Discussion Document No. 3 (1982). However, an extension of privity of estate to cover all covenants, other than those intended to be performed personally by an original party, was recommended in two other jurisdictions without any change to the privity of contract principle, which also applied there : Report on Landlord and Tenant Relationships : Residential Tenancies, Law Reform Commission of British Columbia (1973); Report on Landlord and Tenant Law, Ontario Law Reform Commission (1976).

performing. The objection to this in the case of an incoming assignee seems less strong, because he is in a position to assess in advance what his position will be. Even if all lease covenants are treated the same there could be some difficulty in deciding which obligations were covered. Not every obligation appears in the lease itself. We think that that could be treated as a matter of fact: the court would have to determine whether an obligation was agreed as part of the consideration for the grant and acceptance of the lease.

6.11 To the extent that personal covenants by a tenant are contained in a lease, liability for any breach of them is already generally passed on to assignees. The statutory implied indemnity covenants apply to all "the covenants, agreements and conditions"[117] and do not distinguish between those to which privity of estate applies and those to which it does not. To seek to impose liability for personal covenants on assignees would not therefore be a revolutionary suggestion; rather it should be looked on only as a proposal to relieve the original parties. So far as we know, there have been no complaints about the impact of liability for personal covenants on successors. Presumably, if the decision is against varying the rules relating to personal covenants, the statutory indemnity covenants will remain. One of the

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117 Law of Property Act 1925, Schedule 2, Part IX. For registered land the wording is "covenants and conditions": Land Registration Act 1925, section 24(1).

present effects of the privity of contract principle - the original party and the current landlord or tenant being concurrently liable on a covenant which probably only one of them can perform - will therefore effectively be preserved for this class of obligation.

(d) Provisional conclusion

6.12 In the absence of reported difficulties arising from continuing liabilities under personal covenants, or other pressure for reform, our present view is that no alteration is required to the law relating to covenants not affected by privity of estate, although the definiton of the extent of that principle may require change.

Avoidance

6.13 One matter of particular concern is whether any proposal to abrogate the privity of contract principle should be linked to a further proposal to preclude avoidance of the new arrangements, by a contract designed to have the same effect as the privity of contract principle, and if there are to be anti-avoidance measures how far should they go. We should welcome views on this point, particularly from those who are in support of the suggestion that the privity of contract rule should be abrogated.

6.14 The reason why it seems necessary seriously to consider anti-avoidance measures is because of the entrenched position of the present privity of contract

principle, linked with the considerable dominance of landlords in many sectors of the landlord and tenant market. A parallel can be drawn with the Costs of Leases Act 1958. Prior to that Act, it had been extrememly common practice for landlords to insist that prospective tenants should pay the landlord's legal fees incurred in granting a new lease. The objective of the Act was to reverse the trend which made the payment of the landlord's costs by the tenant the automatic assumption, while permitting the practice to continue if expressly agreed. However, we understand that the practical effect of that Act, for at least 25 years, was negligible. Many leases are granted without any prior formal agreement. In such cases, the tenant frequently finds himself faced with a demand for costs as a condition of completing the arrangement. Where there is an agreement, landlords often insist that it contains the necessary provision to transfer liability for their legal expenses to the tenant. A recent, limited, intervention by the Court seems likely to change the position on the statutory renewal of business premises,[118] but otherwise this practice is largely unchanged since before the passing of the Act. This, we presume, results from the strength of the bargaining position of landlords. We fear that it is likely, if adoption or abandonment of the privity of contract principle is left as a matter of agreement between the parties that, as in the case of the landlords' costs, landlords will merely insist upon retaining the present arrangements, simply because they work in the landlords' favour.

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118 Cairnplace Ltd v. CBL (Property Investment) Co Ltd [1984] 1 All ER 315.

6.15 In considering anti-avoidance measures, one is looking at restrictions on the freedom of contract. For arrangements to be effective, it will be necessary to extend controls beyond mere agreements in a lease that the original parties should continue to be liable after having parted with their interest in the property. The protection would have to extend to other people, and to arrangements made outside the lease. While there might be difficult marginal questions, we envisage that comprehensive legislation would be possible. Restrictions would have to cover any contractual arrangement, whether or not in a lease, which extended obligations in connection with the property beyond the current period of ownership of the lease or reversion to it. There would also be restrictions upon obligations intended to ensure that the covenants were performed beyond that period (e.g. by imposing some sort of penalty if they were not). Restrictions would need to extend to guarantees, indemnity covenants and other forms of collateral contract. The restrictions would make all these contracts void to the extent that they had the forbidden effect.[119]

6.16 Notwithstanding the views we have expressed, we have identified a number of options envisaging how restrictions might be imposed. We should welcome views

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119 Although anti-avoidance provisions in tax statutes are complicated and arguably not wholly effective, we envisage that a provision following the precedent of section 38(1) of the Landlord and Tenant Act 1954 would be simple and effective.

as to which of them would be appropriate, or suggestions for alternatives. The possibilities are -

(a) Restrictions would apply unless the original parties to a lease entered into a written agreement to the contrary. This would, effectively, be little more than reversing the present presumption, and could suffer the fate of the Costs of Leases Act.

(b) At the other extreme, the restrictions could represent a firm rule which would apply invariably and could not be excluded. This would produce certainty, which always helps in the general understanding of the law. Nevertheless, such inflexibility could well produce injustice.

(c) A more flexible approach would allow parties who wished to retain the privity of contract principle, notwithstanding the general restrictions, to apply in advance to a court for authority to do so. This procedure could be analogous to that which is currently available for excluding the automatic repairing liability of the landlord of residential property let for a short period,[120] and to the procedure for excluding the business tenant's right to renew his lease.[121] Certainly, this would involve

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120 Landlord and Tenant Act 1985, s. 12(2).

121 Landlord and Tenant Act 1954, s. 38(4), as amended by Law of Property Act 1969, s. 5.

access to the courts where none is at present needed, but such applications are normally disposed of easily. However, experience of those proceedings, brought by the parties jointly, shows they they do not adequately test the issues and do not effectively allow the court to reach an independent judgment on the facts. The alternative of a full action is likely to take more time, be more costly, consume more resources than would be justified and yet still be subject to the same drawback. To have a court procedure would give certainty: either the abandonment of restrictions was approved by the court, in which case the lease could say so and the provision would be valid, or general rules would apply. However, this does not seem to be possible in a way which is wholly satisfactory.

(d) A different flexible approach would be to permit parties to ignore the restrictions in any case where it was reasonable to do so. Much use is already made of the concept of reasonableness in the area of landlord and tenant, e.g. in assessing whether a landlord should have refused consent to an assignment.[122] Following the precedent of the Unfair Contract Terms Act 1977, the parties could validly contract for continuing liability if that was fair and reasonable.

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122 Landlord and Tenant Act 1927, s. 19(1).

In deciding whether it was, the court would have regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the covenant was entered into. It would be for the party claiming that the covenant was fair and reasonable to show that it was.[123] A difficulty with this suggestion is that much of the certainty in the law is effectively abandoned. Even though it was apparent on the face of a lease that the privity of contract principle was being applied, no assignee or potential assignee could be certain whether the continuing liability was valid and enforceable until court proceedings had been taken. This could provoke unnecessary disputes, and it would be unhelpful when a party wanted to dispose of the property in question. Although the paucity of reported litigation under the 1977 Act indicates that the difficulties would not be serious, we should welcome comments. This is the option which we provisionally favour.

Transitional Arrangements

6.17 When introducing any new rule relating to leases, it is necessary to decide whether or not existing leases should be affected. There are strong arguments against abandoning the privity of contract

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123 See Unfair Contract Terms Act 1977, s. 11.

principle in relation to existing leases. Effectively, that would be retrospective legislation. It would change bargains already made between the parties, and where a lease had already changed hands, the landlord might have agreed to the assignment wholly or partly in reliance upon the fact that the original tenant had a continuing liability.

6.18 Against that, it must be recognised that any reform which is introduced must be regarded as an improvement. The process of making it fully effective will be painfully slow if it applies only to new leases. As leases are commonly granted for terms of 99 years, and sometimes longer, it will be a very long time indeed before any change which only affects new leases will apply universally. In the meantime, there will be two different legal rules, perhaps to diametrically opposite effects, operating in parallel. This is a complication of the law which should be avoided if at all possible. We provisionally conclude, therefore, that any new rules should apply to all leases. Whether it is reasonable to continue to apply the privity of contract principle should be judged, for leases in existence at the date the legislation takes effect, at that date.

Consequential Matters

6.19 A decision to abrogate the privity of contract principle would have certain consequential effects which need to be considered before arriving at a final conclusion.

(a) Covenants Relating to Other Property

6.20 A lease may contain contractual arrangements which have no real connection with the demised property but which cannot be regarded as purely personal, e.g. a covenant restricting the use of other property.[124] As the party who undertakes that type of obligation in a lease does not necessarily do so simply because of his interest in the demised property, it does not follow that when he assigns the leases and ceases to have that interest he should cease to be liable on that covenant. However, we do not see how one could satisfactorily distinguish between non-property obligations which are nevertheless an integral part of the lease bargain - e.g. trading covenants in a "tied house" lease - and those which are truly collateral. That leads us to ask: would harm be done by transferring to the assignee the liability for all obligations in an assigned lease or reversion? The worst position would be that the assignee would find himself under a legal obligation which he was in no position to perform. That is the reverse of the present position, in which that can happen to the assignor. However, if the risk attached only to collateral covenants, the difficulty would occur less frequently than at present when the assignor is at risk in respect of all lease covenants. The practical course therefore seems to be to make no exceptions.

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124 Eg, Cleveland Petroleum Co Ltd v Dartstone Ltd [1969] 1 WLR 116.

(b) Land Charges

6.21 A difficulty could arise where matters which were registerable as land charges had not been registered. The point is illustrated by the facts in Eagon v Dent.[125] The lease contained an option allowing the tenant to require the landlord to grant him a new lease. That option should have been registered as an estate contract,[126] but it was not. Accordingly, it was void against the purchaser of the reversion,[127] and that would remain so even if the purchaser actually had prior notice of the existence of the option. In that case, the original landlord remained liable, even though not in a position actually to grant a new lease. Had the sale of the reversion released him from liability - which would be the effect of abrogating the privity of contract principle - no-one would have been responsible. That result is clearly unsatisfactory for the tenant.

6.22 There are two possible ways to deal with this. The first is to do nothing, because the responsibility for registering is the tenant's, and if his failure to register results in his losing a right he would otherwise have had it can be regarded as his own fault and not unjust. The other alternative is to cease to make such matters registerable when they occur in leases. There is a precedent for this in the

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125 [1965] 3 All ER 334.

126 Land Charges Act 1972, s. 2(4).

127 Ibid, s. 4(5).

provision that a restrictive covenant "between a lessor and a lessee" is not registerable.[128] This should be quite satisfactory because proper practice in buying a lease, or a reversionary interest, must include reading the terms of the lease.

(c) Disclaimer

6.23 When the tenant in whom the lease is currently vested, whether the original tenant or an assignee, is insolvent and the lease is onerous and does not have a capital value which can be realised for the benefit of the creditors, the liquidator[129] or the trustee in bankruptcy[130] may be able to disclaim the lease.[131] The effect of a disclaimer at present varies depending whether it is the original tenant or an assignee who has become insolvent. If it is disclaimed by the original tenant's trustee in bankruptcy or liquidator, the lease comes to an end, and any guarantor of the tenant's covenants is released. On the other hand, if the disclaimer is on behalf of an assignee's estate, the lease remains on foot because the original tenant - possibly among others - has a continuing liability and the court can vest the lease in him.[132]

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128 Ibid, s. 2(5)

129 Companies Act 1985, s. 618 (4).

130 Bankruptcy Act 1914, s. 54(2).

131 Leave of the court may be required.

132 Warnford Investments Ltd v. Duckworth [1979] Ch. 127.

6.24 One result of abrogating the privity of contract principle would therefore be that a disclaimer would invariably bring the lease to an end, because the liability of the only person then responsible would be cancelled. On a recent application for leave to disclaim by a liquidator, Walton J pointed out that although leave would readily be given if the lease had been assigned, the position was different where the original tenant was concerned, because of the release of the guarantor.[133] To abrogate the privity of contract principle would be to bring all cases within the category in which leave to disclaim may be more difficult to obtain.

6.25 It would be undesirable to hinder the winding up of insolvent estates. Yet to relax the court's vigilance in such cases would be to reduce the security afforded to the landlords by guarantors' covenants. However, this is a situation which the parties already not infrequently cover by negotiation. It is not uncommon for a guarantor to covenant with the landlord that if the lease is disclaimed on insolvency, the guarantor will, if called upon by the landlord, accept a new lease in lieu. This effectively prevents the landlord from having the property in hand when he does not want it, and gives the guarantor more control over his own liability than he often has, because, subject to the terms of the lease, he will be able to assign or sublet. We feel, therefore, that this is a matter which can satisfactorily be left to the operation of market forces.

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133 In re Distributions and Warehousing Ltd (1985) 13 CSW 907.

PART VII

SUMMARY OF PROVISIONAL CONCLUSIONS

7.1 The conclusions which we have provisionally reached, and on which we welcome comments, may be summarised as follows:

(a) The application of the privity of contract principle to covenants in leases, and to the equivalent covenants in licences to assign, has been widely criticised on various grounds: that it is intrinsically unfair, not understood, gives rise to demands whch are unexpected and sometimes cause hardship, affords undue protection to landlords, hampers the winding up of deceased's estates, and does not allow those who become liable an adequate opportunity to minimise that liability nor a reasonable chance of reimbursement by the person primarily liable to perform the covenants (paras. 3.1-3.2, 3.14-3.23);

(b) The privity of contract principle operates in accordance with the normal rules of the law of contract, and cannot be criticised on that ground. However, after the lease or the reversion has changed hands, the contractual obligation is to an extent duplicated or supplemented by the liability arising by privity of estate (para. 3.3);

(c) The parties to a lease can, as a matter of bargain, modify the privity of contract principle or cancel its application in relation to any particular transaction. This is rarely done, probably because of the unequal bargaining power of landlords and of tenants; (paras. 3.3, 3.5);

(d) The degree of dissatisfaction with the present rules justifies taking some action (para. 6.1). This should not prejudice the financing of the property market, nor the ease with which tenants can assign leases (paras. 3.26, 5.4(d));

(e) There are a large number of partial solutions to the perceived problems (paras. 5.7-5.40), but, because none solves all the difficulties which may be encountered both by landlords and by tenants, we do not favour any of them (paras. 6.1-6.2);

(f) As no dissatisfaction has been expressed concerning the liability for covenants which are not affected by the privity of estate principle, no change should be made in relation to them, except possibly to redefine which fall within that category (paras. 6.6-6.12);

(g) The recommendation we provisionally make is that the privity of contract principle be abrogated (para. 6.2);

(h) There should be legislation to make void contracts which seek to impose continuing liability, to the extent that they have that effect, unless it is fair and reasonable that they should impose such liability. The burden of proving reasonableness should lie on the party seeking to rely upon the continuing liability (paras. 6.14-6.16);

(i) The new rule should relate to all leases, subject to transitional provisions exempting existing covenants imposing continuing liability where it is fair and reasonable to do so, judged on the basis of the parties' knowledge at the date the legislation commences (para. 6.18).

APPENDIX

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