Neutral Citation Number: [2016] EWHC 3122 (Ch)

Case No: HC 2016 000335

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION

Royal Courts of Justice, Rolls Building
Fetter Lane, London, EC4A 1NL

Date: 08/12/2016

Before :

MR DAVID HALPERN QC SITTING AS A DEPUTY HIGH COURT JUDGE

Between :

ELMFIELD ROAD LIMITED	**Claimant**
- and -	
TRILLIUM (PRIME) PROPERTY GP LIMITED	**Defendant**

Mr Timothy Fancourt QC (instructed by **Nabarro LLP**) for the **Claimant**
Mr Timothy Dutton QC (instructed by **DLA Piper UK LLP**) for the **Defendant**

Hearing dates: 23rd and 24th November 2016

Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

.....

MR DAVID HALPERN QC SITTING AS A DEPUTY HIGH COURT JUDGE

Mr David Halpern QC :

1. This is the latest in a long line of cases concerned with the interpretation of rent review clauses in leases, but the issue in this case arises in a materially different factual context from that of previous authorities.

The relevant documents

2. By a sub-underlease dated 23rd June 1986 ("the Initial Lease") Taylor Woodrow Property Co Ltd (the Claimant's predecessor in title) let the property known as Unicorn House, Bromley ("the Property") to the Secretary of State for the Environment (the Defendant's predecessor in title). The Second Schedule provided that the term of the lease was 25 years from 25th March 1985 and that the annual rent was £551,000, subject to review. Part Two of the Second Schedule provided for upwards-only review to the open market rent at every fifth anniversary, with a final review on 20th March 2010 (five days before the end of the term). I assume that the reason for having a rent review just before the end of the term is that the parties envisaged that the term might continue under Part Two of the Landlord & Tenant Act 1954.

3. On 25th June 1990 it was agreed that the reviewed rent from 25th March 1990 would be £1,160,000. On 4th November 2003 it was agreed that the reviewed rent from 25th March 2000 would remain at that figure. It appears that the rent review for 1995 was never activated, but the parties were content for the rent to remain as it was.

4. On 28th December 2005 four documents were executed or signed. The first is a deed of variation which varied the Initial Lease ("the Deed of Variation"). The most significant variation in relation to these proceedings is that the parties added a new paragraph 2.3 to the Second Schedule as follows:

> "Notwithstanding the provisions of paragraph 3 of Part II of the Second Schedule, the parties hereby agree that for the period commencing 29 September 2005 and ending 24 March 2010 the Rent will be £965,000 per annum."

5. The Deed of Variation also deleted the final rent review on 20th March 2010. The other variations comprised a partial widening of the user covenant, a partial relaxation of the covenant against alienation and the addition of a new clause restricting the landlord's right to elect to waive the building's exemption from VAT. On the face of it, these variations all seemed to benefit the tenant, but Mr Timothy Dutton QC, who appears for the Defendant, argues that, as incorporated into the New Lease, they also benefited the landlord because they increased the market rent for the Property.

6. The second document is a memorandum recording that the yearly rent from 25th March 2000 to 24th March 2005 was to remain at £1.16m. This memorandum duplicates the agreement reached in November 2003; neither party suggested that I should derive anything from this duplication.

7. The third is a memorandum recording that the yearly rent from 25th March 2005 to 28th September 2005 was to remain at £1.16m. This dovetails with the Deed of Variation in that it covers the period up to 29th September 2005.

8. The fourth is a reversionary lease ("the New Lease"). Clause 2 provides for the term to commence on 25th March 2010 (i.e. upon expiry of the Initial Lease) and to expire on 31st March 2022 (subject to a break clause and an option to take a new lease). The clause continues:

> "YIELDING AND PAYING therefor FIRSTLY from the Term Commencement Date … the Initial Rent … the first payment … to be made on the Term Commencement Date and such rent to be subject thereafter to such increase calculated in accordance with the provisions of paragraph 3 of the First Schedule hereto …"

9. Clause 1 of the New Lease defines "Initial Rent" as being:

> "The initial rent payable under this Lease from and including the Term Commencement Date to and including 25 March 2015 being rent equivalent to the greater of (a) the rent first reserved under the Initial Lease immediately prior to the expiry thereof subject to such increase calculated[1] in accordance with the provisions of paragraph 3 of the First Schedule hereto)[2] (b) £1,200,000 per annum exclusive of VAT and (c) the open market rent as determined in accordance with the provisions for review contained in the Third Schedule hereto".

10. This is an important definition which needs to be broken down into its constituent parts. Initial Rent is defined as being the highest of three separate figures or calculations (I shall refer to these as Alternatives (a), (b) and (c)).

a) This is calculated by taking the figure of £965,000 (the rent under the Initial Lease immediately before its expiry) and increasing it in accordance with paragraph 3. Alternative (a) forms an important part of Mr Dutton's submissions and will require further consideration in due course.

b) This is the sum of £1.2 million, which accordingly becomes the minimum Initial Rent under the New Lease.

c) The Third Schedule defines the market rent as the best yearly rent at which the premises might reasonably be expected to be let in the open market on the terms of the New Lease, subject to the usual assumptions and disregards.

---

[1] Both the reddendum and the definition of Initial Rent use the phrase "*such increase calculated*"; I assume this should read "*such increase as is calculated*".

[2] There is a closing bracket but no opening bracket. I agree with Mr Dutton that the opening bracket should be put before "subject to".

11. The definition of Initial Rent is unusual in giving the landlord the best of three Alternatives. The landlord will not receive less than the market rent in March 2010, but the landlord has the certainty that it will receive £1.2m if this is more than the market rent. Finally, the landlord has the benefit of Alternative (a), which will apply only if it produces a higher figure than (b) or (c).

12. Clause 3 incorporates into the New Lease all the provisions of the Initial Lease, save as varied by the First Schedule. Paragraph 3 of that Schedule provides (so far as relevant) as follows:

> "The provisions of Part II of the Second Schedule shall be deleted and the following provisions shall apply instead.
>
> 3.1 **"Base Figure"** 193.1;
>
> **"Index"** "all items" index figure of the Index of Retail Prices …;
>
> **"Review Date"** 25 March 2015 and 25 March 2020;
>
> **"Review Period"** a period beginning on any Review Date and ending on the day before the next Review Date or if none until the end of the Term.
>
> 3.2 Until the first Review Date the annual Rent will be the Initial Rent and thereafter during each successive Review Period the annual Rent will be a sum equal to the greater of:
>
> 3.2.1 the annual rent reserved under this Lease immediately before the relevant Review Date; and
>
> 3.2.2 the revised rent ascertained in accordance with this clause.
>
> 3.3 The annual Rent for any Review Period is to be determined at the relevant Review Date by multiplying the Initial Rent by the Index for the month preceding the relevant Review Date and dividing the result by the Base Figure."

13. The Deed of Variation and the two rent memoranda were all made between Wichford Bromley Ltd (a successor in title to the original landlord) and the First Secretary of State (a successor in title to the original tenant). The New Lease was made between Wichford Bromley Ltd and the Defendant. However, the three documents to which the Secretary of State was party were all signed on his behalf by the same individual who signed the New Lease. Mr Dutton confirmed (as is clear from these documents) that there is a close connection between the Secretary of State and the Defendant.

14. In my judgment it is obvious on the face of the documents, and without reference to extrinsic evidence, that these four documents all form part of a single transaction. This is obvious from the following facts:

i) They all bear the same date;

ii) Three are between the landlord and the outgoing tenant and the fourth is signed on behalf of the new tenant by an attorney acting on behalf of the outgoing tenant;

iii) All four refer back to the Initial Lease; and

iv) Each deals with rent in relation to a consecutive period of time.

15. On 21st July 2010 the parties signed a memorandum stating that the Initial Rent was to be £1.2m a year from 25th March 2010. I mention this for the sake of completeness, but it plainly cannot affect the construction of the New Lease, which was granted in 2005 and must therefore be construed in the light of the matrix of facts as at 2005, even though it did not take effect until 2010.

16. It is common ground between the parties that 193.1 is the index figure on the "all items" Index of Retail Prices ("the Index") as at September 2005. This is a matter on which Mr Dutton understandably places considerable reliance.

17. Finally, in relation to the facts, Mr Dutton relies on Heads of Terms which preceded the four documents signed on 28th December 2005. (I propose to deal in a later section of my judgment with the admissibility of this extrinsic evidence as a matter of law and with its relevance as a matter of fact. I am postponing this analysis because I find it easier to explain my conclusions in this way, but I confirm that in reaching my decision I have regard to this material as part of the totality of the evidence which I am considering.)

Submissions and discussion

18. I start by asking myself, What is the natural meaning of the disputed words in sub-paragraph 3.3 of The First Schedule to the New Lease? The New Lease incorporates all the provisions of the Initial Lease, save as varied. The Initial Lease had contained a conventional formula for rent reviews by reference to market rent. This is replaced in the New Lease by paragraph 3 of The First Schedule, which I have set out in full at paragraph 11 above. I remind myself that sub-paragraph 3.3 says: "*The annual Rent for any Review Period is to be determined at the relevant Review Date by multiplying the Initial Rent by the Index for the month preceding the relevant Review Date and dividing the result by the Base Figure.*" Each of the terms which is capitalised is defined in sub-paragraphs 3.1 or 3.2, save for "*Initial Rent*" which is defined in clause 1 of the New Lease.

19. Mr Fancourt's primary submission is very simple. In December 2005, when the New Lease was executed, the parties did not yet know what the Initial Rent would be under the New Lease. They knew only that it would be the highest figure of three

Alternatives. However, it is clear from paragraph 3 that whatever figure was to become the Initial Rent should be multiplied by whatever would be the Index figure at the Review Date divided by 193.1 (the Base Figure). By March 2015, the parties knew that the Initial Rent was £1.2m and that the Index figure was 256.7. Accordingly, the figure produced by applying the formula in sub-paragraph 3.3 is £1.2m x (256.7 ÷ 193.1) = £1,595,235.63. I agree with Mr Fancourt that this is the natural meaning of paragraph 3 when read literally, with such references as are necessary to other parts of the New Lease to explain the capitalised terms.

20. Mr Dutton's primary submission is more complex. He says that it is necessary to construe paragraph 3 together with Alternative (a) of the definition of Initial Rent, and that the court must have also regard to the genesis of the Base Figure, to the presumption which applies when construing rent review provisions and to the Heads of Terms. I shall consider these submissions in turn.

The Base Figure and the Initial Rent

21. I agree with Mr Dutton that the Base Figure and the Initial Rent are relevant in the following ways:

i) The Base Figure is the Index figure as at September 2005;

ii) Under the Deed of Variation, that is the date on which the rent under the Initial Lease was reduced from £1.16m to £965,000;

iii) The use of that figure as the Base Figure was plainly not a coincidence but was intended to provide for an increase based on the period from September 2005;

iv) The Initial Rent was not intended to be (and was not in fact) determined until 2010;

v) The effect of Mr Fancourt's construction is that, on the rent review in 2015, the Initial Rent determined in 2010 is increased by reference to the increase in the Index between September 2005 and February 2015.

22. In my judgment these matters, by themselves, are not sufficient to rebut the natural meaning of the words. (I shall consider below the impact on these matters of the presumption arising on a rent review.) However, Mr Dutton submits that there is a tension which exists between paragraph 3 of The First Schedule and Alternative (a) of the definition of Initial Rent. He says that I should not construe paragraph 3 in isolation but should do so in the context of the document as a whole, and hence that I cannot sidestep this tension.

23. The opening words of Alternative (a) are: "*the rent first reserved under the Initial Lease immediately prior to the expiry thereof*". This refers to the passing rent under the Initial Lease immediately before it expired, i.e. £965,000. (That figure was known at the date when the New Lease was executed, but it is theoretically possible that the parties might have agreed to vary it between 2005 and 2010; that may explain why it is identified in a roundabout way.) The difficulty relates to the second part of

Alternative (a): "*subject to such increase calculated in accordance with the provisions of paragraph 3 of the First Schedule hereto)*".

24. Mr Dutton submits that these words show that sub-paragraph 3.3 is doing double duty; it supplies the multiplier, not only for the rent review provision in sub-paragraph 3.2, but also for Alternative (a), which is one of the possible ways of calculating the Initial Rent. There is a mismatch between the two provisions for the following reasons:

i) Sub-paragraph 3.3 refers to the rent for any Review Period, which is defined as a period beginning on a Review Date; the Review Dates are in 2015 and 2020; on a literal interpretation, this does not apply to the computation of the Initial Rent in 2010;

ii) It says that the rent is to determine at the relevant Review Date, which gives rise to the same problem; and

iii) It says that the rent is to be determined by reference to the Initial Rent; however one cannot apply this formula in order to work out the Initial Rent itself.

25. Mr Dutton's solution to this apparent conundrum is to say that sub-paragraph 3.3 contains an obvious error. Instead of saying "*the Initial Rent*" it should say "*the rent payable under the Initial Lease immediately prior to expiry*", i.e. £965,000. This is an obvious mistake which should be corrected without the need for rectification. Once corrected, the calculation required for Alternative (a) of the definition of Initial Rent will start with the correct figure. A further benefit of correction is that it will make the rent review accord with commercial common sense, since the figure to be multiplied will be the rent payable on the date from which indexation is to be applied. I shall return to the question of commercial common sense, but for the moment I will focus on whether there is indeed a conundrum.

26. Largely for the reasons advanced by Mr Fancourt, I do not accept that the difficulty perceived by Mr Dutton exists. My reasons are as follows:

i) Sub-paragraph 3.3 provides the machinery for reviewing the rent in 2015 and 2020. As stated above, there is no difficulty in giving it a literal interpretation.

ii) Initial Rent is defined in clause 1 as being the highest of three Alternatives. Alternative (a) is £965,000 "*subject to such increase calculated in accordance with the provisions of paragraph 3 of the First Schedule hereto*". The words "*in accordance with*" indicate that one is to apply paragraph 3 in some way, but perhaps not literally. If it had said "*pursuant to*" this might have required a literal application.

iii) Even on Mr Dutton's solution, one cannot apply paragraph 3 literally, since it is necessary to read "*Review Date*" as including 25th March 2010 (the effective date of the New Lease). Since it is necessary to give "*Review Date*" an extended meaning for the purpose of Alternative (a), there is nothing surprising in also having to give the opening words of sub-paragraph 3.3 an extended meaning when applying them to Alternative (a).

iv) Alternative (a) provides that one way of calculating the Initial Rent is to take the previously passing rent of £965,000 and to increase it in accordance with paragraph 3. This is simply a shorthand way of incorporating such parts of paragraph 3 as will serve the purpose of index-linking the historic rent. Mr Fancourt submits that "*in accordance with*" means "*using the methodology of*"; another way of putting this is to say that paragraph 3 is to be incorporated *mutatis mutandis*. The consequence is that the figure of £965,000 will be uplifted by an amount equal to the increase in the Index between September 2005 (when it stood at 193.1) and February 2010.

v) Paragraph 3 is concerned exclusively with rent review and makes sense on its own. The fact that Alternative (a) includes a slightly clumsy incorporation of paragraph 3 which requires some adaptation of paragraph 3 for the purpose of Alternative (a) is no reason for giving paragraph 3 a different meaning in its proper context as the rent review provision.

Presumption of the purpose of a rent review provision

27. Mr Dutton relies on *British Gas Corporation v. Universities Superannuation Scheme Ltd* [1986] 1 WLR 398 at 401G-402B, where Sir Nicholas Browne-Wilkinson V-C said:

> "There is really no dispute that the general purpose of a provision for rent review is to enable the landlord to obtain from time to time the market rental which the premises would command if let on the same terms on the open market at the review dates. The purpose is to reflect the changes in the value of money and real increases in the value of the property during a long term. Such being the purpose, in the absence of special circumstances it would in my judgment be wayward to impute to the parties an intention that the landlord should get a rent which was additionally inflated by a factor which has no reference either to changes in the value of money or in the value of the property but is referable to a factor which has no existence as between the actual landlord and the actual tenant, i.e., the additional rent which could be obtained if there were no provisions for rent review. Of course, the lease may be expressed in words so clear that there is no room for giving effect to such underlying purpose. Again, there may be special surrounding circumstances which indicate that the parties did intend to reach such an unusual bargain. But in the absence of such clear words or surrounding circumstances, in my benefit which he could never obtain on the market if he were actually letting the premises at the review date, viz., a letting on terms which contain judgment the lease should be construed so as to give effect to the basic purpose of the rent review clause and not so as to confer on the landlord a windfall provisions for rent

> review at a rent appropriate to a letting which did not contain such a provision."

28. He submits that the intention behind paragraph 3 is to compensate the landlord for changes in the value of money since the effective date of the New Lease, that the parties' chosen methodology is to increase the rent by reference to changes in the Index, and that it makes no commercial sense for the multiplier to be fixed by reference to a date in 2005 when the multiplicand represents the rent in 2010.

29. Mr Fancourt submits that *British Gas* and other cases which follow it are dealing with a different issue, viz. how to construe a rent review clause which provides for rent to be reviewed by reference to a hypothetical lease. Whilst I accept that that was the factual context in which the Vice-Chancellor made his observation, in my judgment it was intended to have more general application. The extract which I have quoted specifically refers to "*changes in the value of money*" as well as to "*real increases in the value of property*".

30. It might well be the case that it is unusual for rents to be reviewed by reference to the Index rather than market rents (although Mr Dutton says that rents at Canary Wharf are reviewed by reference to RPI). Both Counsel agree that it is very unusual to find a clause in the form of the definition of Initial Rent in the New Lease, which gives the landlord three Alternatives, including one which is increased by the Index and a second which constitutes the market rent. Nevertheless, in my judgment the observation in *British Gas* is as applicable to RPI as to market rents.

31. Accordingly I hold that there is a presumption that, if the rent is index-linked, the parties intend the indexation to increase the rent in line with inflation from the date when the passing rent was fixed. If the rent is to be reviewed from the initial rent, one would expect the indexation to run from the date of the lease; if the rent is to be reviewed from a previous review date, one would expect the indexation to run from the previous review date. It would be as curious to increase the rent by indexation over a longer period as it would be curious to increase the rent by reference to the market value of a hypothetical lease which was more valuable than the actual lease.

32. Of course, as Browne-Wilkinson V-C stated, the presumption may be rebutted. The issue in this case is whether it is rebutted. This is the aspect of the case which has given me the greatest pause for thought. Mr Fancourt submits that the present case is most unusual. By reading the Deed of Variation with the New Lease, one can see that there is a carefully structured bargain between the parties as follows:

    i) The rent as from September 2005 is reduced from £1.16m to £965,000. There is no evidence as to whether the market rent in 2005 was £965,000 or £1.16m or some other figure. However, even if the property was over-rented before September 2005 the landlord has given up an entitlement to receive rent at the level previously agreed.

    ii) A number of provisions are altered in the tenant's favour. Although, as Mr Dutton submitted, this could theoretically have benefited the landlord by producing an increase in the market rent, I regard the alterations as principally for the tenant's benefit. The rent is fixed from 2005 to 2010, and market rent

is only one of the three Alternative bases for fixing the rent in 2010 (in the event it was not used, presumably because it did not give the highest figure).

iii) The inclusion of Alternative (a) can only benefit the landlord (see paragraph 11 above).

iv) I am unable to reach any conclusion as to whether the rent review provision in the New Lease favours the landlord or the tenant. On the one hand, it provides for indexation over a longer period than the period since the rent was fixed, but on the other hand the landlord will not have the benefit of any real increases in the rental value of the Property in excess of inflation after 2010.

33. These unusual facts are far removed from the typical case, such as *British Gas*, where (i) the only transaction between the parties is the grant of a long lease in exchange for a rent and (ii) the parties contemplate at the outset that the value of the rent will or might have been eroded by the time of the rent review. Mr Fancourt does not make any positive submission that this carefully calibrated renegotiation of the existing relationship between landlord and tenant makes commercial sense. On the contrary he says he does not know, not least because his client is the successor in title to the landlord who negotiated these terms. What he says is that it is not clear that the overall arrangement is commercially absurd. I agree. The rent review provision is but one part of a complex overall transaction in which each party makes some gains and some losses. It is not clear which party is the net winner, nor is it clear that they had in mind any particular pattern in respect of rent increases between 2005 and 2010 and between 2010 and the review dates.

34. I was not addressed on the question whether the presumption in *British Gas* should be regarded as weakened by *Arnold v. Britton* [2015] AC 1619 (considered below). I can see the force of the argument that courts today should place greater emphasis on the natural meaning of the words which the parties have chosen to use. However, I have heard no detailed submission on this point and I therefore refrain from expressing a concluded view. Instead I assume in Mr Dutton's favour that *Arnold v. Britton* has made no difference in this respect.

35. There is, however, one consequence of Mr Fancourt's construction which is particularly troubling. If the rent in 2010 had been determined in accordance with Alternative (a), the rent would have been £965,000 uplifted by changes in the Index between September 2005 and February 2010. At the first review in 2015, the rent would be uplifted by changes in the Index between September 2005 and February 2015. On this scenario, there really is double-counting.

36. Mr Fancourt's answer is to say that Mr Dutton's solution is also uncommercial. In the first place, the landlord has accepted a very considerable reduction in the rent which he could have charged between 2005 and 2010; this might be the *quid pro quo*. Secondly, the rent review provision confines the landlord from 2015 to indexation on a figure fixed in 2010. It therefore deprives the landlord of any increase in the real value of property (over and above inflation) since that date. Given that the definition of Initial Rent shows that the parties had in mind both increases in the market rent and in the Index, it would be surprising to find that they had deprived the landlord of the subsequent increase in real value without giving an additional benefit in lieu.

37. I am left with the uncomfortable feeling that the landlord might be taking advantage of a mistake which nobody noticed in 2005. However, it is not clear to me that there was a mistake, nor (in these unusual circumstances) is it clear that the only sensible commercial objective of the rent review was to give the landlord an increase on a rent fixed in 2005 in order to compensate for inflation since 2010.

The Heads of Terms

38. Mr Dutton places reliance on a document entitled "*Proposed Heads of Terms*" made between Wichford Bromley Ltd and the Secretary of State and dated 24th August 2005 ("the Heads of Terms"). The document is marked "subject to contract" and "without prejudice", but an email exchange between the parties' respective surveyors confirms that both parties agreed the heads of terms. This clearly means that the terms were agreed subject to contract.

39. Mr Fancourt objects to this evidence on the ground that it falls foul of the prohibition on adducing evidence of the negotiations between the parties. However he sensibly agreed that I should look at the evidence *de bene esse* in order to decide whether or not it was admissible. At one stage he also objected on the ground that some of the evidence was introduced too late, but he did not pursue that objection once Mr Dutton had disclaimed reliance on part of the evidence.

40. The Heads of Terms are divided into two parts. Part A is headed "*Deed of Variation to Existing Lease*". This summarises, without any significant differences, the provisions which in due course were embodied in the Deed of Variation and the two rent memoranda. Part B is headed "*Reversionary Lease*". This sets out the principal terms of the New Lease. The sub-paragraph headed "*Rent*" is in substantially the same terms as the definition of "*Initial Rent*" in the New Lease. The sub-paragraph headed "*Rent Reviews*" says:

> "25 March 2015
>
> 25 March 2020
>
> Rent to be determined in line with RPI CHAW Index".

It is common ground that the RPI CHAW Index is the RPI All Items Index which has a base figure of 100 as at January 1987.

Are the Heads of Terms admissible and, if so, for what purpose?

41. Mr Dutton relies on the classic statement of Lord Wilberforce in *Prenn v. Simmonds* [1971] 1 WLR 1381 at 1384-5, in particular at 1385A-B and H:

> "It may be said that previous documents may be looked at to explain the aims of the parties. In a limited sense this is true: the commercial, or business object, of the transaction, objectively ascertained, may be a surrounding fact. Cardozo J. thought so in the Utica Bank case. And if it can be shown that one interpretation completely frustrates that object, to the

> extent of rendering the contract futile, that may be a strong argument for an alternative interpretation, if that can reasonably be found. But beyond that it may be difficult to go ....
>
> In my opinion, then, evidence of negotiations, or of the parties' intentions, and a fortiori of [one party's] intentions, ought not to be received, and evidence should be restricted to evidence of the factual background known to the parties at or before the date of the contract, including evidence of the "genesis" and objectively the "aim" of the transaction."

42. Mr Dutton submits that this remains good law and has survived both *Chartbrook v. Persimmon* [2009] 1 AC 1101 and *Arnold v. Britton.*

43. Mr Fancourt submits that there is a distinction between heads of terms which have contractual effect and those which do not. The latter include terms which are agreed subject to contract. He says that the latter category is inadmissible in the construction of the agreement which follows on from non-binding heads of terms. He relies for this submission on *Matchbet Ltd v. Openbet Retail Ltd* [2013] EWHC 3067(Ch), where Henderson J said at [132]:

> "To the extent that the provisions of the Heads of Terms were not contractually binding, they were no more than steps in the pre-contractual negotiations between the parties and, as such, they are excluded by the exclusionary rule."

44. In my judgment, Mr Fancourt is seeking to give this dictum a degree of weight which it will not bear. Pre-contract negotiations generally have a lower status than preceding contracts between the same parties, albeit that the latter may also be excluded if there is an "entire agreement" clause in the new contract which creates a contractual estoppel (as happened in *Matchbet*). However, as I read this dictum, Henderson J is simply stating that non-contractual heads of terms fall within the general rule in *Prenn v. Simmonds*. He is not saying that they are excluded from the exception in *Prenn v. Simmonds* which permits evidence to be given which assists in establishing the genesis and aim of the transaction. Any other conclusion would be inconsistent with *Prenn v. Simmonds*. (The reference to *Matchbet* in *Lewison on The Interpretation of Contracts* (6th edition) at 3-05 is consistent with my conclusion, in that it occurs as part of a discussion about reliance on prior concluded agreements.)

45. I agree with Mr Dutton that *Prenn v. Simmonds* has not been overruled by later authority. The passage which I have quoted from Lord Wilberforce's speech (paragraph 41 above) is part of a longer passage which was quoted with approval in *Chartbrook* at [31]; furthermore, *Prenn* was cited with approval in *Arnold v. Britton* at [14] and [15]. There is a separate issue as to whether less weight should be given to this presumption following *Arnold v. Britton.* I adopt the same approach as I have done in relation to *Prenn v. Simmonds* (see paragraph 34 above). I have heard no detailed submission on this point and therefore refrain from expressing a concluded view, but I assume in Mr Dutton's favour that *Arnold v. Britton* has made no difference in this respect.

46. I also accept Mr Dutton's submission that it is not necessary to find an ambiguity or obvious lacuna in the contract in order to look at pre-contract negotiations: see the authorities cited in section 3.17(b) of *Lewison*.

47. Nevertheless, as Mr Dutton rightly accepted, the pre-contract negotiations are admissible only for such limited purposes as the law permits and must otherwise be ignored. The permitted purposes include resort to this material (i) in order to explain "*the genesis and objectively the aim of the transaction*" (see paragraph 41 above), (ii) to identify the meaning of a descriptive term (*Prenn* at 1384B and *Chartbrook* at [33]), (iii) to establish that a fact which may be relevant as background was known to the parties (*Chartbrook* at [42]) and (iv) to establish a claim for rectification or estoppel (*Chartbrook* at [42]).

48. Mr Dutton submits that the Heads of Terms are admissible in the present case in order to show "*the genesis and objectively the aim of the transaction*". Breaking this down, he says that the reference to the "*genesis*" of the transaction means that the court should look at the history of the negotiations. The Heads of Terms provide a snapshot at a particular date, and I should use this to test Mr Fancourt's submission that the overall arrangement in 2005 cannot be said to have been commercially absurd. The reference to *"the aim"* of the transaction entitles the court to look at the parties' commercial objectives. He acknowledges that the court is not permitted to resort to the pre-contract negotiations in order to explain the meaning of the words used in the New Lease, but he submits that there is a distinction between the permitted and the prohibited uses of the Heads of Terms. The distinction to be drawn is between those matters of principle which the commercial parties agree as Heads of Terms and those matters of detailed drafting which are left to the lawyers, whose job it is to turn the Heads of Terms into a detailed agreement.

49. I do not accept these submissions, for the following reasons which are largely those advanced by Mr Fancourt:

i) It is clear from *Prenn v. Simmonds* that Lord Wilberforce regarded the general rule as being a prohibition on referring to pre-contract negotiations, subject to limited exceptions.

ii) The phrase "*the genesis and objectively the aim of the transaction*" is a composite phrase which is a quotation from a judgment of Cardozo J. Lord Wilberforce clearly understood the phrase to mean substantially the same as Lord Blackburn, whose observations were summarised by Lord Wilberforce as follows (at 1384B):

> "We must, as he said, inquire beyond the language and see what the circumstances were with reference to which the words were used, and the object, appearing from those circumstances, which the person using them had in view."

iii) The Heads of Terms would have been relevant if, for example, it was not clear from the documents that Wichford Bromley Ltd and the Secretary of State were in a pre-existing landlord and tenant relationship which they were proposing to recalibrate into a new relationship between Wichford Bromley

> Ltd and the Defendant. However, since these facts can be ascertained from the documents themselves, there is no need to resort to the Heads of Terms for this purpose.

50. Mr Dutton made another submission which went even further. He relied on the following dictum of Sales J in *Investec Bank (Channel Islands) Ltd v. The Retail Group plc* [2009 EWHC 476 (Ch):

> "Accordingly, in interpreting a contract, regard may be had to the content of the parties' negotiations to establish 'the genesis and object' of a provision. This seems to me to be a relevant part of the factual matrix, since if the parties in the course of their negotiations are agreed on a general objective which is to be achieved by inclusion of a provision in their contract, that objective would naturally inform the way in which a reasonable person in the position of the parties would approach the task of interpreting the provision in question."

51. It is not clear whether Sales J was simply applying the rule in *Prenn v. Simmonds* or whether he intended to extend it to evidence which shows the genesis and aim of a provision within the transaction. The word "*accordingly*" appears to be a reference to the previous paragraph in the judgment, where he cites from *Chartbrook* in the Court of Appeal, which does not warrant this extension. (Sales J delivered his judgment before *Chartbrook* reached the House of Lords.) Mr Dutton was unable to point to any authority prior to *Investec* which extended *Prenn v. Simmonds* in the way in which he contends that Sales J arguably extended it.

52. If Sales J did intend to extend the law, I respectfully dissent from that conclusion. The genesis and aim of a particular provision may be sufficiently important to qualify as part of the genesis and aim of the whole transaction. If so, it will be admissible pursuant to *Prenn v. Simmonds*; if not, it is contrary to *Prenn v. Simmonds* to allow it to be admitted.

53. In *Excelsior Group Productions Ltd v. Yorkshire Television Ltd* [2009] EWHC 1751 (Comm) at [25], Flaux J commented on *Investec* as follows:

> "It seems to me that there is a very fine line between looking at the negotiations to see if the parties have agreed on the general objective of a provision as part of the task of interpreting the provision and looking at the negotiations to draw an inference about what the contract meant (which is not permissible), a line so fine it almost vanishes. However, I do not need to decide whether the approach adopted by Sales J survives the restatement of the exclusionary rule in *Chartbrook*."

I respectfully agree. The practical difficulty of applying this extended test is a further reason why the law should not be extended in the manner for which Mr Dutton contends.

54. I now turn to consider what Mr Dutton seeks to derive from the Heads of Terms. He relies on them in support of two submissions, one negative and one positive:

i) The negative submission is to counter Mr Fancourt's submission that paragraph 3 cannot be said to be wholly uncommercial.

ii) The positive submission is that the words "*Rent to be determined in line with RPI CHAW Index*" under the heading "*Rent Reviews*" in the Heads of Terms provide support for his construction of paragraph 3.

55. I reject both submissions. In the first place, they are attempts to use the Heads of Terms to explain the meaning of the New Lease, which is impermissible. Secondly, even if this were permissible, no clear picture emerges from the evidence. At most it shows that the parties reached an agreement subject to contract, presumably before they instructed solicitors. It does not tell me whether they later changed their minds.

56. There is a further problem with Mr Dutton's positive submission. Although it tends to suggest (albeit not clearly) that the parties intended to use the Index to increase the rent in line with inflation and not at a greater rate, it does not indicate how the parties intended to do so. There are two possibilities. The one for which Mr Dutton contends is that the multiplicand should be £965,000. The other possibility, for which neither side contends, is that the multiplier should be the increase in the Index from the effective start of the New Lease. These two possibilities yield significantly different outcomes.

57. The sentence on which Mr Dutton relies is to be found under the heading "*Rent Reviews*". Contrary to what it says, it is concerned not with "*determining*" the rent but with reviewing the rent previously determined; hence it should not be read literally. If anything, this sentence tends to support the alternative possibility, which is that the rent review provision was intended to index-link a rent to be ascertained in 2010; hence the index-linking should run from 2010.

58. Mr Fancourt raises a further difficulty. He says that even if it a mistake was made in paragraph 3, the court cannot correct it unless it is clear what the parties intended to agree. He relies on the following passage in the judgment of Arden LJ in *Scottish Widows and Life Assurance Society v. BGC Fitzgerald* [2012] EWCA Civ 607 at [21]:

> "Accordingly, there are circumstances in which the court may, if it finds from the face of the document interpreted with the admissible background, that the parties have mistakenly included, or omitted, words in a document, interpret the document so that it has the meaning which, according to the document read with the admissible background, the parties clearly intended. As the subsequent case of Chartbrook makes clear, however, there are limitations. In particular:
>
> i) It must be clear from the document interpreted with the admissible background that the parties have made a mistake and what that mistake is;
>
> ii) It must be clear, from the rest of the agreement interpreted with the admissible background what the parties intended to agree,

iii) The mistake must be one of language or syntax."

59. Mr Dutton counters this by referring to the following passage in the judgment of Carnwath LJ in *KPMG v. Network Rail Infrastructure Ltd* [2008] 1 P&CR 11 at [65] to [67]:

> "In the present case, for the reasons I have given, it is obvious from a reading of the 1985 version on its own that something has gone wrong. Comparison with the 1974 draft leaves no doubt as to the parameters of the error. It lies in the transposition of the second part of the parenthesis. I agree, however, with the judge, that comparison of the two versions, by itself, does not yield a definitive answer. In my view it leaves only two realistic possibilities: either too much was left out, or not enough. Either (a) the relevant words should not have been left out, and the parenthesis was intended to remain as in the 1974 draft; or (b) it was intended to leave out not just the relevant words, but the whole of the second part of the parenthesis, that is, the increased rent condition.
>
> For my part, if the latter alternative had been still in play, I would have seen some attractions in it. It would have the great advantage of simplifying the over-elaborate language of the paragraph. Furthermore, it is doubtful if it would have made much difference in substance. Since the lessor is unlikely to serve a rent review notice unless he expects to achieve at least some increase, there may be little practical purpose in a specific condition requiring an *actual* increase. Such considerations might well have led those advising the lessor on the revisions to the draft lease in 1980 to decide that the condition should be omitted altogether, as Mr Amlot understood it to do. Such considerations might also explain why he did not find it a particularly surprising change. Furthermore, in choosing between the competing versions (a) and (b), there would be a principled case for choosing the version which least favoured the originator of the document (the *contra proferentem* rule).
>
> As it is, we do not have to make that choice. However, the existence of two plausible alternatives does not undermine the case for correction, or force the court to adopt a solution which has no plausibility at all. I have no doubt that Mr Driscoll's proposed interpretation, based on the 1974 draft, is a better reflection of the parties' intentions than Mr Nugee's. Unlike the judge, I can see no legal obstacle to its adoption."

60. *Network Rail* was not cited in *Scottish Widows*. *Lewison* at 9.01 deals with the apparent inconsistency between the two cases by quoting Brightman LJ's dictum in *East v. Pantiles (Plant Hire) Ltd* [1982] 2 EGLR 111 that "*it must be clear what correction ought to be made in order to cure the mistake*" and by adding the following footnote: "*It is sufficient if the gist of the correction is clear: KPMG v.*

Network Rail." In view of my conclusion that it is not clear that a mistake was made, I need not resolve the question whether Mr Dutton needs to establish that it is clear what the correction should be.

61. The points which Mr Dutton seeks to derive from the Heads of Terms are points which should properly be made, if at all, in a claim for rectification. Mr Fancourt very fairly accepted that the Claimant will not argue that the Defendant is debarred by these proceedings from bringing subsequent proceedings for rectification. I say nothing to encourage or discourage such proceedings.

Arnold v. Britton

62. Both parties refer to paragraphs [15] to [23] of *Arnold v. Britton* which set out the legal test which I have to apply (save in relation to the admission of pre-contract negotiations, which I have dealt with separately). These passages are so well known that I do not need set them out again. My attention was particularly drawn to paragraphs [17], [18] and [20].

63. Because of the unusual facts of this case I have found it more convenient to address the issues in the way set out above. However, I must now review my conclusions using the template which Lord Neuberger provides at [15]. For the reasons set out above, my conclusions are as follows:

i) The natural and ordinary meaning of paragraph 3 is as set out in paragraph 19 above.

ii) The only other relevant provision of the New Lease is Alternative (a) of the definition of Initial Rent. For the reasons given in paragraphs 21 to 26 above, I do not consider that Alternative (a) has any bearing on the natural meaning of paragraph 3. It is rather the reverse. Paragraph 3 has to be adapted from its natural meaning in order for it to be incorporated *mutatis mutandis* into Alternative (a).

iii) The overall purpose of the clause and of the New Lease as a whole is to recalibrate an existing landlord and tenant relationship. It is impossible to reach any conclusion from the documents as to the parties' shared intention with regard to indexation of rent.

iv) As regards the facts and circumstances known or assumed by the parties at the time that the document was executed, I have taken into account the fact that the figure of 193.1 is the Index figure as at September 2005. I have concluded that the Heads of Terms are inadmissible but that, even if I were to admit them, no clear picture emerges from them.

v) The tenant's strongest point is that the literal outcome appears contrary to commercial common sense (taking into account the extrinsic evidence of the Index figure of 193.1). However, for the reasons given in paragraphs 27 to 37 above the present case is so different from cases such as *British Gas* that the

presumption as to the purpose of a rent review provision is rebutted on the facts of this case.

vi) Finally, bearing in mind that the process of construction is an iterative one, I have reviewed these conclusions in the round to see whether Mr Dutton's points collectively carry greater weight than they do individually. My conclusion is that they are not sufficiently strong to displace the literal meaning.

Disposition

64. I therefore conclude that paragraph 3 of the First Schedule to the New Lease bears the meaning for which the Claimant contends and that the Defendant has failed to establish that there is any mistake which should be corrected by construction of the New Leasc.