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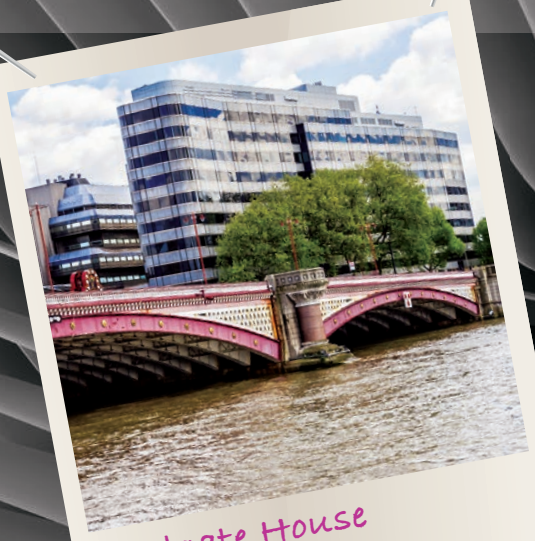

Rates mitigation – what future for Guardian schemes?

Guardian schemes

The recent decision of the Court of Appeal in *London Borough of Southwark v (1) Ludgate House Limited and (2) Andrew Ricketts* (VO) [2020] EWCA Civ 1637 (handed down last December) has inevitably caused consternation amongst owners of empty office premises, in particular those seeking to mitigate their liability for business rates pending a redevelopment. The **"Guardian scheme"** depends for its efficacy on the occupation by the individuals being treated as displacing (at least in part) the building owner's rateable occupation of the whole building and the former being subject to Council Tax on a unit by unit (or floor by floor) basis. If the listing officer is willing to aggregate all the residential units on a particular floor, this gives rise to a material overall reduction in the rates payable by the owner, at a time when the redevelopment of the building is delayed for any reason (e.g., failure to obtain a suitable planning permission or to satisfy all necessary planning conditions).

The efficacy of such schemes is now in question. At the time of writing, the ratepayer has **sought permission** to appeal to the Supreme Court but the outcome is unknown. It is instructive, however, to pause and reflect on where matters stand following the Court of Appeal's decision.

Context for mitigation

The background to Guardian schemes is well-documented, but by way of reminder, the trigger for a boom in their use (and that of other mitigation schemes) was the combined impact of section 45 of the Local Government Finance Act 1988 (liability for unoccupied hereditaments), the Rating (Empty Properties) Act 2007 and the Non-Domestic Rating (Unoccupied Property) (England) Regulations 2008, SI 2008/386. Subject to the exceptions set out in the 2008 Regulations, all owners of empty properties in England and Wales became liable for 100% of the business rates which would be payable in respect of occupied properties. The relevant exceptions (for mitigation purposes) include the first three months of vacancy (increased to six months for industrial and warehouse hereditaments), listed buildings and premises where the owner is insolvent.

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This equivalence of liability for empty premises (where there is clearly no tenant entitled to occupy or in actual occupation and the landlord, therefore, has no rental income) has given rise to a substantial increase in the use of mitigation schemes, of which there are broadly four variants:

1. The use of recurring licences or tenancy arrangements for periods of occupation in excess of six weeks (to trigger a three-month period of relief, or six months as referred to above) is commonplace but subject to increasing scrutiny by billing authorities;
2. less common is the device of a licence or

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tenancy granted to a charity to secure the 80% mandatory relief, where the Charities Commission can be expected to challenge any perceived misuse of charitable status where occupation by a registered charity is directed solely towards obtaining rates relief, leading to charities becoming less willing to "lend" their charitable status to property owners to achieve relief;

3. the use of the insolvency regime to avoid liability is a third type of scheme regularly used, where (as the law currently stands) it is entirely legitimate for a special purpose vehicle established for the sole purpose of taking a lease of vacant premises to be placed in administration after lease grant to claim the insolvency exemption in the 2008 Regulations, with the administration timetable managed by the owner (of both the property and the SPV) so as to extend the period of exemption. The courts have had no alternative but to permit these insolvency-based schemes (as in *The Secretary of State for Business, Energy and Industrial Strategy v PAG Asset Preservation Limited and MB Vacant Property Solutions Limited* [2020] EWCA Civ 1017, where the Secretary of State sought to have the SPVs wound up for abuse of the insolvency regime) but have made it clear in obiter remarks that although such schemes are compliant with law, it is for Parliament to legislate if their use for rates mitigation is to be outlawed. There is increasing pressure for Parliament to take action in this area, which is aligned with the growing opposition of landlords and billing authorities to the increased use of CVAs (creditors' voluntary arrangements) in recent years to reduce rents and business rates (in the latter case, for a limited period only) under the guise of a company rescheduling its liabilities in preparation for sale;
4. the Guardian scheme of rates mitigation, which is the focus of this article.

It is instructive to review the course of events which led to the Court of Appeal's decision in *Ludgate House.*

The factual matrix underlying the recent decision

Following the expiry of its lease of the whole of Ludgate House (an office building of just over 16,000 square metres at the southern end of Blackfriars Bridge in London), Express Newspapers vacated the building in March 2015 and its owner (Ludgate House Limited, "LHL") applied for planning permission for its redevelopment (incorporating another building to the east) as a mixed-use structure straddling the operational Thameslink railway lines leading to Blackfriars Station.

There were delays in obtaining the necessary consents from Network Rail and the decision was taken by LHL to put in place a rates mitigation scheme offered by VPS (UK) Limited ("VPS"). Proposals for Guardian occupation were drawn up by VPS and agreed with LHL, subsequently incorporated in an agreement entered into between the parties on 29th July 2015 (a few weeks after the occupation by Guardians of a number of units in fact commenced). The agreement provided for the grant of licences to the individual Guardians, the key provisions of which were:

- the Guardians had no right to exclusive possession or occupation of any part of the building;
- the Guardians were permitted to share occupation with such others as VPS might designate;
- the Guardians had no right to occupy a particular room (although in practice individuals stayed for some time in the same room);
- VPS reserved the ability to require Guardians to move to a different room (and the licence stated that such a request to relocate could be made on a regular basis); and
- the Guardians were expected to challenge anyone who had unannounced access to the building and, if thought by a Guardian to be appropriate, report them to the relevant authorities.

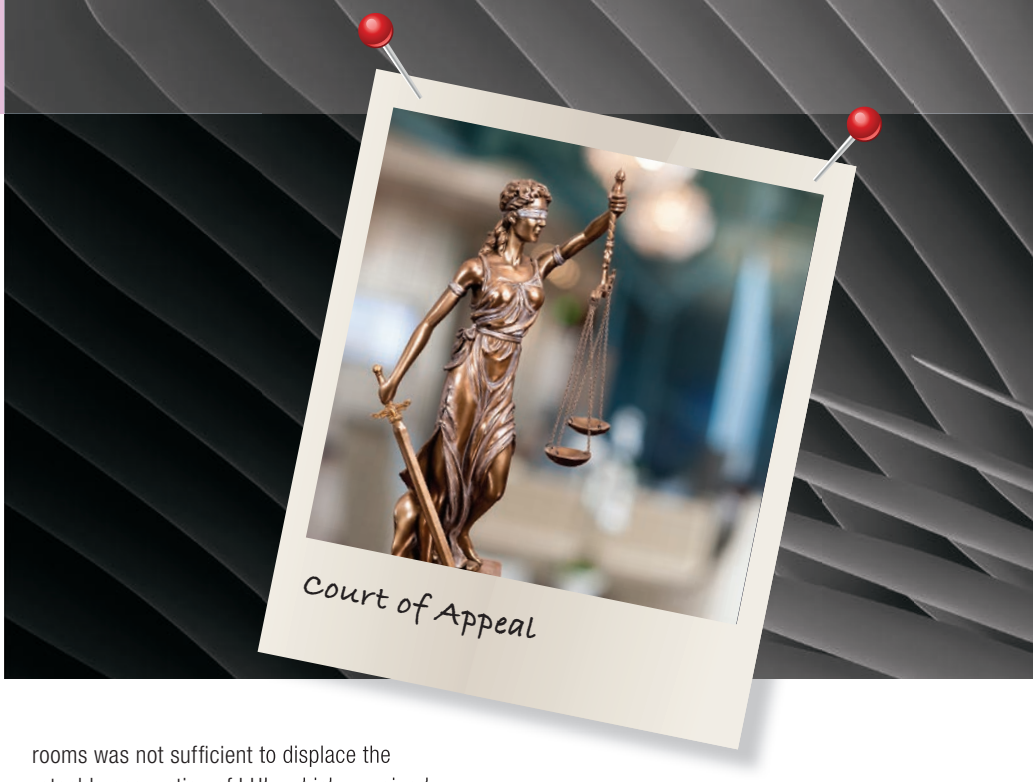
VPS had granted various licences to Guardians from 1st July 2015 onwards and Ludgate House proved to be a popular building. At the peak of the operation, there were as many as **52 Guardians in occupation**. Although some did not stay long, four individuals were living at the premises for around 22 months and remained in the same four rooms, each of which was capable of being locked.

The grant of licences, rather than leases or tenancy agreements, was to avoid the Guardians acquiring security of tenure, but the lack of exclusive possession proved to be the deciding factor in the Court of Appeal's reasoning, as referred to below.

Liability for rates and the proposals

So far as rates liability is concerned, the key date for LHL was 25th June 2015, by which time three months had elapsed since the building became empty (and the initial relief from business rates had expired). A proposal was made to delete Ludgate House from the 2010 rating list on the basis that the whole of the building was domestic (meeting the tests set out in section 66 Local Government Finance Act 1988) and, therefore, subject to council tax.

The VO inspected Ludgate House on 25th November 2015 and two days later deleted the property from the rating list,



being satisfied that it was now occupied by Guardians for residential use. Although not of crucial significance, Ludgate House actually comprised two hereditaments and the effective dates of deletion were in fact 25th June 2015 as to the larger part and 1st December 2015 as to the remainder.

LB Southwark (having become aware of the deletions) inspected Ludgate House on 11th January 2016 and on 29th February 2016 made proposals challenging the VO's alterations of 27th November 2015. Those proposals sought the restoration of both entries to the rating list, on the basis that the property was **wholly non-domestic**. There followed a second inspection by the VO on 4th May 2016, following which he restored Ludgate House to the list on 31st May 2017 (with effect from 25th June 2015) but excluding the 1st and 2nd floors (to which the residential units were deemed to be confined for the purposes of the list). Then, on 16th August 2017, a further VO alteration was made, this time to refer to the whole building but at the same rateable value as in the May alteration.

Naturally, this prompted further ratepayer proposals on 24th August 2017, most materially to delete the new entry or to reduce the assessment to £1 (as the building was claimed to be wholly domestic). The final ratepayer proposal was made on 27th September 2017, seeking amendment of the list to show Ludgate House as more than one entry.

The VTE Hearing

The six appeals were consolidated, and the case heard by the VTE on 28th February and 7th March 2018. The Vice-President had inspected Ludgate House the previous October, which at that time was in the process of soft-strip demolition. At the hearing, she noted the prevalence of such mitigation schemes but found that the terms of the contract with VPS left overall control of the building with LHL. In particular, the contract did not allow VPS to grant exclusive possession of any part to the Guardians, whose duties (as set out in their licences) included the provision of a basic level of security.

The Vice-President found that the occupation by the Guardians of individual rooms was not sufficient to displace the rateable occupation of LHL, which remained in occupation of the whole building. In fact, she held that the Guardians were occupying as agents for LHL, with LHL's occupation being paramount, and that Ludgate House therefore comprised a single non-domestic hereditament with effect from 1st July 2015.

The Upper Tribunal

The appeal was heard over three days in July 2019 and identified the key issue as the identification of the correct number of hereditaments at Ludgate House on 1st July 2015. The Tribunal considered whether the first four licensees in the building occupied separate hereditaments of which they were the rateable occupiers. For that to be the case there would need to be distinct units of occupation and the four characteristics of rateable occupation would have to be met in respect of each unit.

It was agreed by the billing authority's counsel that although the legal rights of occupation conferred on the licensees are important, it is the manner in which the arrangements are managed in practice and the quality of the occupation actually enjoyed which is the correct approach.

VPS had indicated to prospective Guardians that there would be at least one room at Ludgate House per individual. Most individuals had their own private living space from which all others were excluded. Printed cards were placed on each door showing the name of the occupant. The geographical test in *Woolway (VO) v Mazars* [2015] UKSC 53 was, therefore, satisfied in respect of each unit, although some residents used adjoining areas within the common space to a greater or lesser degree. The Tribunal concluded that on 1st July 2015 there were four sufficiently distinct units of occupation capable of being separate hereditaments.

The Tribunal then turned to the question as to who was in rateable occupation of the four units and concluded that the Guardians were. They occupied those units for 22 months from 1st July 2015 and such occupation was paramount as against the **"competing"** occupier, being LHL as owner of the whole building. The Tribunal disagreed with the VTE's conclusion that the licensees were in occupation as agents for LHL – they were in no contractual relationship with LHL and no service was provided by them to the company. Further, they could only be removed from the building on notice from VPS (and not from LHL).

This finding was based on the requirement (for rateable occupation) that occupation must be **"exclusive for the particular purposes of the possessor"**. The primary purpose of occupation, from the Guardians' perspective, was to have somewhere to live, satisfied by the provision of a separate room for each licensee which could be locked by them. The four ingredients of rateable occupation (as set out in *John Laing & Son Ltd v Kingswood Assessment Committee* [1949] 1KB 344) were present. The Tribunal found no evidence of general control by LHL

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of the individual rooms and did not accept the council's argument that LHL was in paramount occupation.

The Tribunal found that the four rooms were separate hereditaments, and the rateable occupiers were the individual Guardians. They were liable for Council Tax as the occupations were for residential purposes. As the parties had agreed before the hearing that if there was more than one hereditament at Ludgate House the VO's alterations to the list made on the basis that there was a single composite hereditament could not be supported, the Tribunal ordered that Ludgate House should be removed from the list with effect from 1st July 2015.

Court of Appeal

The appeal (confined to points of law on the basis of the facts as found by the Upper Tribunal) was heard on 24th and 25th November 2020 and the judgment was handed down on 4 December.

Lewison LJ summarised the deliberations and findings of the Upper Tribunal and ultimately allowed the appeal by the billing authority.

The Court observed that ascertaining what is a hereditament (which is key to establishing if the Guardians were in rateable occupation) is a matter of interpreting judge-made law. Lewison LJ referred in particular to *Cardtronics Europe Limited v Sykes (VO) ("Cardtronics SC")* [2020] UKSC 21, which confirmed that there are two linked aspects to the question – one geographic (or cartographic) and the other how it is occupied. As Lord Carnwath noted in that case, these concepts have proved both resilient and adaptable to accommodate new developments.

The geographic/cartographic test involves a check for visual or cartographic unity, in simple terms **"can you draw a continuous red line round the putative hereditament on a plan?"**. If the area within the red line is self-contained, in the sense that all parts can be accessed without entering another's land, then it is a single hereditament: see *Woolway* (cited above). It had been made clear in *Cardtronics Europe Limited v Sykes (VO) ("Cardtronics CA")* [2018] EWCA Civ 2472 that this test is a matter for factual or evaluative judgment.

The Upper Tribunal had decided that an individual room occupied by a Guardian was sufficiently identifiable to be a separate hereditament and there was no appeal to the Court in respect of that conclusion. However, Lewison LJ then turned to the second (linked) aspect referred to above, namely the manner of occupation. This is dependent on whether there is a person potentially in rateable occupation – despite the evident circularity of such an approach. The judge drew from the classic case of *John Laing* (cited above) the statement of Tucker LJ that **"the decision in this case primarily depends on the proper construction to be put on the general conditions which form the contract between the parties"** and interpreted this to mean that the question of who is in rateable occupation depends (at least in part) on the terms of the contract.

This interpretation led Lewison LJ to conclude that the terms of the contract governing the Guardians' occupation were critical in establishing whether they were themselves in rateable occupation of the respective rooms. The measure of control by the Air Ministry of the contractors in *Laing* was not such as to alter the character of their occupation (of certain huts etc required for the construction of runway extensions), with the result that the contractors were held to be in rateable occupation. That conclusion (in *Laing*) was reached following an analysis of the terms of the contract and this concept of control was central to the decision in *Cardtronics SC*.

The requirement for exclusive possession for a person to be in rateable occupation was referred to by both Lindblom LJ and Lord Carnwath in *Cardtronics SC*. Lewison LJ also referred to *Westminster Council v Southern Railway* [1936] AC 511 for authority in circumstances where paramountcy of occupation has to be determined in order to identify the rateable occupier – the key question being who is in paramount occupation of the premises in question. Mention was also made of the landlord/lodger relationship discussed by Lord Russell in *Southern Railway*, where the general control by the former of the building occupied in part by the latter made the landlord liable for payment of rates.

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Key to Lewison LJ's reasoning in this case was that he considered that where a contract contains terms which, were they to be exercised, would interfere with the occupant's enjoyment of the premises then the existence of such terms indicates general control by the party entitled to so interfere. He was, however, also aware of the need to consider the factual position on the ground (it being immaterial whether the instrument conferring the right to occupy is a lease, licence, or easement). Also apparent in the chain of reasoning is the consideration of both parties' respective purposes – e.g., in the landlord/lodger example, although the lodger's purpose is to enjoy the living space the landlord's purpose in running the business of letting lodgings must also be taken into account and is determinative in deciding which party is liable for rates.

The judge referred to *Cardtronics CA* and the common purpose of the owner of the site on the one hand and the ATM operator on the other, where the retention by the owner of general control over the operations (this being physical or contractual control)

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was sufficient to make the controlling party the rateable occupier of the whole site, including the ATM site. He concluded that contractual control is enough to determine the question as to who is liable. The clear *ratio decidendi* in the *Ludgate* case was the degree of control exercised by Ludgate House Limited over the Guardians, as identified by the Court of Appeal from its interpretation of the contractual provisions, regardless of what happened in reality. There is here an opportunity for an appeal to the Supreme Court, at the time of writing the ratepayer had indeed submitted an application for permission to appeal.

It is interesting to reflect on whether the outcome of the appeal would have been different had tenancy agreements been granted by VPS to the Guardians (and permitted under the agreement between LHL and VPS). The answer is almost certainly **"yes"**, as it was the precarious nature of the Guardians' occupancy pursuant to the licences that the Court interpreted as being insufficient to displace the control by LHL of the individual rooms and led to LHL being held liable for rates as owner of the whole building. However, it would clearly not have suited LHL's purposes for the Guardians to have any permanency of occupation, which would be subject to the provisions of the Protection from Eviction Act 1977.

Lewison LJ was not persuaded by LHL's argument that the occupation of an employee under a service contract or a caretaker (where neither is the rateable occupier) is peculiar to the employment law context and arises solely from the relationship between employer and employee. The judge's authorities for the rejection of that argument were a Scottish case (*IRC v Leckie* 1940 SC 343) and a Northern Irish case (*Commissioner for Valuation v Trustees of the Redemptorist Order* [1971] NI 114). In his judgment, occupation by Guardians is analogous to occupation by such employees, and likewise by lodgers.

He was critical of the rationale of the Upper Tribunal's decision and took issue with the following points in particular:

- "the Guardians were providing no service to LHL" – the judge's view was that a security service was indeed being provided;
- the purpose of the Guardian's occupation (as a residence) was not the only consideration – the purpose of LHL must also be taken into account (namely to keep the premises secure) in determining who is the rateable occupier;
- the provision of a key to enable the Guardian rooms to be locked – this was not conclusive, as the same could be said of a lodger who would remain such even if they also had a key to the front door of the lodgings;
- the terms of the licence were not inconsistent with a residential use – the correct question was in fact whether the terms of the licence were consistent with exclusive occupation by the Guardians; and
- the Upper Tribunal's consideration of who had paramount occupation did not allow for the fact that LHL (in terms of its contract with VPS) had not given up possession of any part of Ludgate House. The purpose for which Ludgate House was used was a common purpose, so the correct question to ask is **"who is in general control?"**. Although there was no evidence of such general control being actually exercised, the Tribunal should have asked itself what effect the exercise of control (by LHL) would have had, if exercised.

Lewison LJ concluded, in light of his above reasoning, that LHL remained in general control of all parts of Ludgate House and, therefore, the Tribunal was wrong to find that the four Guardians were in rateable occupation of their respective rooms.

Observations

As referred to above, the use of such Guardian schemes for rates mitigation is commonplace and a justifiable reaction to the imposition in 2008 of empty property rates at the same level as for occupied properties. Unless and until the decision of the Court of Appeal in *Ludgate House* is overturned by the Supreme Court (or another Guardian case reaches the Court of Appeal and is distinguished from the *Ludgate House* decision) the granting of licences to Guardians as a meanwhile use pending redevelopment of vacant office buildings will be perceived by property owners and developers as being unsafe for rates mitigation. The success of such a scheme depends for its success on the right of the Guardians to exclusive occupation of the residential unit, an entitlement expressly denied by VPS both in an alert at the

beginning of the standard-form licence and in the body of the document on a number of occasions. In this context, only by relying on the reality principle (i.e., the fact of exclusive occupation as a Guardian's residence notwithstanding the terms of their licence) can a building owner succeed in transferring the liability to the individual residents (by way of council tax, by reason of the domestic use). That interpretation has been denied by the Court of Appeal's decision and **it remains to be seen** if the Supreme Court will reverse the decision (if LHL pursues an appeal, assuming permission is granted).

The UK as a whole, in common with other nations, is currently in a very uncertain property market where landlords will inevitably find it difficult to find tenants for their empty buildings. The continued imposition of 100% rates in such circumstances will assist local authority funding only in the short term, as landlords will not be willing or able to carry this financial burden beyond a reasonable period – the inevitable consequence will be landlord insolvency (leading to rates exemption for SPVs set up to compartmentalise individual properties and limit loss for the holding entity) or premature demolition of buildings which otherwise would have been available in due course for renewed occupancy. A balanced approach needs to be taken, so the private sector and its funders (including e.g., pension funds) are not subjected to a disproportionate burden.

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To conclude, Government needs to give proper consideration to the balance to be struck between adequate local authority funding and the support of a vibrant private sector providing business accommodation to assist in the regrowth of a vibrant economy. It is suggested that issues to be tackled as a matter of urgency include:

- a reduction from 100% empty rates liability to, say, 50%. This could easily be achieved by a statutory instrument, as section 45 (4A) Local Government Finance Act 1988 provides for any percentage between 50 and 100, as ordered by the Secretary of State;
- other means of supporting local authority funding, for example an increase in central government subsidy in the short to medium term or a restructuring of the overall tax burden between different categories of tax; and
- a revitalisation and conclusion of the much-vaunted Business Rates Review consultation, with meaningful reform leading to a more balanced incidence of this tax.

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