Estate Rentcharges and Positive Covenants: An Analysis.

Michael W. Poulsom LLB LLM Solicitor (non-practising), Senior Lecturer, Manchester Metropolitan University

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Abstract

The use of estate rentcharges to enforce postitive freehold covenants appears to be increasing. Estate rentcharges are conceptually difficult. Uncertainty as to their effectiveness and proper application in practice is unsatisfactory for rent owners, rent payers and lenders. Current mechanisms for their proper regulation are inadequate.

A) Context

In 2019, several UK lenders including Barclays Bank and Nationwide Building Society changed their UK Finance Mortgage Lenders' Handbook Part 2 entries to restrict the circumstances in which they will accept properties subject to Estate rentcharges as security for a debt[1]. This suggests that their use, rather than diminishing as was anticipated in 2002[2], has become sufficiently widespread to attract lenders' attention and concern. Practice notes from firms specialising in property development either comment on[3] or even actively promote[4] their use.

[1] UK Finance, 'UK Finance Mortgage Lenders' Handbook for Conveyancers' <www.cml.org.uk/lenders-handbook/englandandwales>, accessed 25 September 2019

[2] Susan Bright, 'Estate Rentcharges and reasonableness', [2002] 66 Conv, Sept/Oct 507, 513

[3] Eversheds Sutherland, 'Estate rentcharges: A cause for concern for secured lenders?' <www.eversheds-sutherland.com/global/en/what/articles/index.page?ArticleID=en/Litigation_Support/rentcharges> accessed 10 April 2019

[4] Womble Bond Dickinson, 'New build houses – the demise of the leasehold and what comes next', <www.Womblebonddickinson.com/uk/insights/articles-and-briefings> accessed 18 June 2019

Estate rentcharges are widely understood as a means by which freehold positive covenants can enforced against successors in title of original covenantor. Their continued use, over 40 years after the Rentcharges Act 1977 prohibited the creation of 'traditional' rentcharges, might be attributed to the lack of better methods of enforcing freehold positive covenants, public and political opposition to leasehold houses[5], commercial and public policy pressure on housebuilders to provide green space and other communal areas[6], and reluctance by Local Authorities, facing reduced central government funding[7], to adopt such areas, necessitating payment for their ongoing maintenance by other means.

A) The Estate Rentcharge – A difficult concept

Estate rentcharges as a concept are not easily understood. This difficulty arises from the terminology used, and from their reliance on the assembly of a series of disparate property law 'components'. An initial ambiguity is what is meant by 'estate rentcharge'. There is no requirement for an 'estate' in the sense of multiple properties. Furthermore, 'rentcharge' may refer both to a proprietary interest and to a financial sum. Perhaps significantly, a House of Commons briefing paper, while clearly referring to the concept, tries to avoid this uncertainty by calling them 'estate charges'[8].

[5] Ministry of Housing, Communities and Local Government, *Implementing reforms to the Leasehold system in England: A consultation*, 2018, 6
[6] Houses of Parliament Parliamentary Office of Science and Technology, *Green Spaces and Health*, POSTnote 538, 2016, 4
[7] Houses of Parliament Parliamentary Office of Science and Technology, n6, 4
[8] House of Commons Library, *Freehold houses: estate charges,* Briefing Paper Number 8497, 2019

The uncertain nature of rentcharges can in part be attributed to inconsistent statutory provisions. S. 1 Rentcharges Act 1977 defines a rentcharge as '*an annual or other periodic sum charged on or issuing out of land, except …(a) rent reserved by a lease or tenancy, or (b) any sum payable by way of interest'*. This clearly refers to the sum owed by the rentcharge payer to the rentcharge owner. This perception of a rentcharge as a monetary sum is reinforced by s. 205(1)(xxxiii) Law of Property Act 1925 ('LPA') which includes within the definition of 'rent' 'a…rentcharge or other…payment in money or money's worth'.

S.1(2) LPA, however, defines rentcharges as proprietary rights. Defining '*the only interests or charges in or over land…capable of subsisting … at law',* it refers to '*a rentcharge in possession issuing out of or charged on land being either perpetual or for a term of years absolute'*[9]*.* Whether 'rentcharge' properly refers to the sum owed to, or to the interest in land held by, the intended recipient might appear inconsequential, but such inconsistency complicates the concept, and reduces the confidence which landholders, suspicious of the motives of property developers or their advisers, are likely to have in it.

B) <u>The Estate Rentcharge - a difficult device</u>

If it is accepted that estate rentcharges are treated as a means of enforcing freehold positive covenants, it is argued that their main feature is a complexity which some

[9] Law of Property Act 1925 s1(2)(b)

descriptions (e.g. that they are 'archaic and quirky'[10] or indeed 'straightforward in practice'[11]) understate or overlook. This complexity contrasts with the attractive conceptual simplicity of the doctrine of mutual benefit and burden, or with the relative simplicity of chains of indemnity covenants or requirements that new owners covenant directly with original covenantees.

The current use of the rentcharge as a technical device appears to share few features with its earlier purpose, which was to meet the cost of the growing need for housing in the nineteenth century[12]. Particularly in Bristol and Manchester, developers sold freehold land at a discount, addressing the shortfall with a liability to pay an additional annual sum secured by a rentcharge.

The primary purpose now served by estate rentcharges, that of a mechanism for compelling performance of freehold postitive covenants is technical and practical, rather than merely financial. But whether, and how, they achieve this purpose appears neither agreed, nor fully understood. There is no obvious connection between a relatively straightforward device for deferring capital payment for a new freehold property and an intricate device designed, for example, to compel householders to pay for the ongoing upkeep of a play area or shared accessway, drain or green space.

Illustrating the extent to which misunderstanding appears to dominate discussion of how, at a fundamental level, estate rentcharges operate, Practical Law describes as a 'common misconception'[13] (apparently shared by the Law Commission[14]) the belief

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[10] Practical Law Property 'Rentcharges: overview' <https://uk.practicallaw.thomsonreuters.com> accessed 29 March 2019, 2

[11] *Sweet & Maxwell's Conveyancing Practice*, Editor David Rees, (Conv Prac R.82: September 2017), 7036

[12] *Roberts v Lawton* [2016] UKUT0395 (TCC) [5]

[13] Practical Law Property, n10, 2

[14] The Law Commission, *Transfer of Land Report on Rentcharges* (Law Com No 68, 1975) para 49

that rentcharges 'make positive covenants run with land'[15], explaining that what runs with the land is not the covenant itself 'but the rentcharge (that is, the interest land held by the rent owner)'[16].

Key to the practical utility of estate rentcharges appears to be s.1(2)(e) LPA which permits the creation, as legal interests enforceable against successors in title of the charged land, of *'Rights of entry…annexed, for any purpose to, a legal rentcharge'*. The annexation of a right of entry to an estate rentcharge can readily be understood; statute permits it. What is less clear is how precisely the creation of a rentcharge with an annexed right of entry can render enforceable a potentially unlimited number of varied and onerous positive covenants.

The requirement under s.1(2) LPA that to exist at law, rights of entry must be annexed to (and given that s.1(2) is a restrictive provision, the implication is that it is only to) a legal rentcharge suggests that in this context, the rentcharge exists merely as a 'platform' onto which the right of entry is added. But this does not of itself explain how the right of entry can then provide a covenant enforcement mechanism. S.1(2) does not expressly permit this. The most evident explanation is that the annexation of the right of entry to the rentcharge can, by relying on and imparting a significant facilitative function to the phrase 'for any purpose', somehow be made to have the desired effect of rendering positive covenants enforceable in practice.

[15] Practical Law Property, n10, 2
[16] Practical Law Property, n10, 2

At face value, ‘for any purpose’ would appear to connote a ‘purpose’ which is already permitted by other property law principles The interpretation which appears to apply here, however, is that a purpose which property law does not normally permit, can, by some unexplained process, assume some unspecified ‘permitted’ status simply by its association with a rentcharge and annexed right of entry: Purposes for which such rentcharges may be created apparently include circumvention of the decisions in *Austerberry v Oldham Corp.*[17] and *Rhone v Stephens*[18] that positive covenants should not be enforceable except against the original covenantor. In another context, it might be asked whether the imposition of a rentcharge and right of entry could, contrary to established principles, compel a servient landholder to acknowledge the existence of an easement to a view[19], or to permit the unrestricted use of an easement to serve land other than a dominant tenement[20].

The absence of adequate explanation of *how* rentcharges operate is reflected in practitioner guidance. Practical Conveyancing Precedents provide a precedent TP1 transfer which appears to annex the right of entry directly to failure by the transferee to compy with several positive covenants[21], but offers no explanation of how this process works, or of how it circumvents the requirement in s.1(2)(e) that to exist at law, such rights must be annexed to a legal rentcharge.

[17] *Austerberry v Oldham Corpn* (1885) 29 Ch D 750
[18] *Rhone v Stephens* [1994] 2 AC 310
[19] Contary to the decision in *William Aldred’s Case* (1610) 9 Co Rep 57b
[20] Contrary to the principle in *Harris v Flower* (1904) 74 LJ Ch 127
[21] Trevor M Aldridge, *Practical Conveyancing Precedents* (Sweet & Maxwell, 2019) R.49: September 2015, Forms 1/687

Practical Law notes that the position is complicated further by the fact that the rentcharge deed will 'usually (but not always)'[22] contain an express covenant to pay the rent, this covenant being additional to the liability imposed by the rentcharge itself. This might suggest that practitioners doubt the enforceability of the rentcharge itself, since if this were beyond question, the additional covenant would be redundant. It also creates uncertainty as to whether a freeholder who duly pays the sum required is complying, or believes they are complying, with the rentcharge (to which under s.1(2)(e) LPA a right of entry can be annexed), or with the covenant (to which, it appears, statute does not allow such annexation). If it is the latter (which it is suggested is likely because the covenant to pay will be more prominent, or least more accessible, within the documentation), such compliance is likely, knowingly or otherwise, to be with a covenant which, being positive, is not technically enforceable. It is possible, therefore, that inclusion of a covenant to pay the rentcharge sum in effect undermines the integrity of a rentcharge scheme.

C) An Unsatisfactory Dependence on the Right of Entry

The effectiveness of estate rentcharges therefore appears to depend in large part on the attachment to them of a concept wholly unappealing in a freehold context, that of a right of entry. If leasehold is widely (if not wholly accurately) perceived to be 'inferior' land ownership, it is not immediately clear what benefit arises from applying to freehold ownership a concept which resembles forfeiture.

[22] Practical Law Property, n10, 2

The right of entry arises, and is governed, either by statute or by express agreement. The statutory right of entry is set out in s.121(3) LPA. Significantly, the Rentcharges Act 1977 did not amend the section, indicating that the preservation of estate rentcharges by that Act received lmited attention or was intended to be merely temporary. This section, headed 'Remedies for the recovery of annual sums charged on land', would appear to apply only where sums due are unpaid, whether or not accompanying covenants have been performed. S.121(3) allows, subject to contrary intention, the party entitled to the annual sum to 'enter into possession' of the charged land. No legal demand is required[23].

Of greater utility is express rights of entry, agreed when rentcharges are created and conventionally drafted to be exercisable following the breach of any positive covenant, and not just covenants to pay the rentcharge sum. Even if it as accepted that the direct annexation of a right of entry to a positive covenant is possible, several conceptual and practical difficulties remain unresolved.

The first is the close resemblance of the procedure to forfeiture of a lease for breach of covenant. Freehold purchasers are unlikely readily to consider the loss of their entire freehold estate a proportionate response to failure to perform covenants. Further difficulties arise from the nature of the right of entry and from its operation in this context. Gray & Gray note that 'It is not necessary for the enforcement of the right of entry that the person against who it is raised should be technically bound by the positive covenants in question: it is sufficient that there is, de facto, a non-

[23] Rentcharges Act 1977 s121(3)

performance of these covenants.' [24] It therefore appears that the operation of a properly constructed rentcharge scheme depends on a party potentially being liable to a legal sanction, described as 'not facultative but penal in nature'[25] without having personally breached a duty. A housebuilder ('H') might sell a property to the first owner ('A') simultaneously imposing positive covenants, supported by an estate rentcharge and a right of entry. If A sells the property to B, the estate rentcharge, and the risk of becoming subject to the exercise of the right of entry, will pass to B. The obligation to perform the covenants rests with A, but it is against B that any right of entry will be exercised. This appears harsher than forfeiture in leases. A lessee facing forfeiture will normally do so because of a breach of a duty which *it* is liable to perform.

Additional procedural difficulties follow from the nature of the right of entry. Owing to the combined and complicated effects of s.205(1)(xxiii) LPA (which includes 'a rentcharge' within the definition of 'rent' and includes a 'fee farm rent' within the definition of a rentcharge) and s.146(5)(a) LPA (which includes 'a grant at a fee farm rent' within the definition of a lease), it appears that exercise of rights of entry for breach of covenants other than to pay the rentcharge sum requires service of a s.146 notice. Moreover, Practical Law notes that the correct procedure for exercising the right of entry is unclear, since it appears to fall outside Part 55 of the Civil Procedure Rules (which concerns the forfeiture of leases), and may come under CPR 40.16 and 40.17 which concern a court's power to order possession and sale of land[26].

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[24] K Gray and S F Gray, *Elements of Land Law* (5th edn, Oxford University Press, 2009) 250
[25] K Gray and SF Gray, n24, 816
[26] Practical Law Property, 'Rentcharges: enforcement' https://ukpracticallaw.thomsonreuters.com accessed 10 December 2019, 6

D) The Rentcharges Act 1977 and the Preservation of Estate Rentcharges

In report No. 68, the Law Commission stated it was 'unsurprised that people feel that a liability to pay an annual sum to a former owner…is repugnant to freehold ownership'[27] and that 'a high proportion of rent payers find perpetual rentcharges … conceptually unacceptable'[28]. With regard to Estate Rentcharge schemes, however, while not commenting at length on their use, it acknowledged both their utility[29] and that at the time of the report they were 'in common use'[30].

The Rentcharges Act 1977 s.2(1) prohibits the creation of new rentcharges. S.2(2) renders void any instrument 'to the extent that it purports to create a rentcharge the creation of which is prohibited by the section'. S.2(3)(c) provides an exception for estate rentcharges. S.2(4) defines an estate rentcharge as one created for the purpose-

> *(a) of making covenants to be performed by the owner of the land affected by the rentcharge enforceable by the rent owner against the owner of the time being of the land; or*
>
> *(b) of meeting, or contributing towards, the cost of the performance by the rent owner of covenants for the provision of services, the carrying out of maintenance or repairs, the effecting of insurance or the making of*

[27] The Law Commission, n14, para 26
[28] The Law Commission, n14, para 26
[29] The Law Commission, n14, paras 48-51
[30] The Law Commission, n14, para 49,

any payment by him for the benefit of the land affected by the rentcharge, or for the benefit of that and other land.

Several observations may be made. The first relates to the relationship between ss. 2(4)(a) and 2(4)(b). S.2(4)(a) does not distinguish between positive and negative covenants, and (unless 'perform' was intended to connote a positive act, which is not stated) presumably applies to both. S.2(4)(b) relates specifically to covenants to reimburse the cost incurred by the rent owner of the services referred to, which are by nature positive. It might be asked what s.2(4)(b) adds to what is already covered by s.2(4)(a).

Secondly, the absence in s.2(4)(a) of any explanation of *how* estate rentcharges make covenants enforceable by the rent owner against the landowner appears merely to perpetuate the assumption that this is simply an effect that rentcharges have the capacity to impart. But this assumption, coupled with the absence of any distinction in s.2(4)(a) between positive and negative covenants appears to overlook the operation of freehold covenants more broadly: A restrictive covenant, the burden of which has passed in equity under *Tulk v Moxhay*[31], and the benefit of which has passed by, for example, annexation is likely be enforceable in any event. As such, is there a risk that an estate rentcharge which purports to *make* covenants enforceable, when they are already enforceable by other means, rendering any purported 'enforceability making' effect redundant, falls outside the definition in s.2(3)(c) and is therefore void under s.2(2)?

[31] *Tulk v Moxhay* (1848) 2 Ph 774

Thirdly, the wording of s.2(4) appears to have departed some way from the Commission findings which preceded it. The Commission outlined two rentcharge schemes in common use[32]. One envisaged a nominal rentcharge, the purpose of which was '*to create a set of positive covenants which are actually designed to preserve the development as a whole, but which are directly enforceable because they happen incidentally to support the rentcharge*'[33]. This appears a little misleading, not least because the conventional explanation is that the rentcharge supports the covenants, not vice versa. In addition, if it was the intention that s.2(4)(a) should preserve this type of nominal rentcharge scheme, it is unclear why it appears to extend to negative covenants.

The second scheme envisaged a management company, created by the developer or by the unit holders to provide services, which needs the (positive) covenants by the unit holders to pay or contribute financially to those sums to remain enforceable. It acknowledged that the second scheme differed from the first in that the sum to be paid would not be nominal (and could be variable), and that its purpose was not 'the performance of positive covenants by the rent payer, [but]…to ensure performance of obligations by the rent owner'[34]. This justification, which appears to draw an artificial distinction between covenants to pay money and other positive covenants, is difficult to follow: The ability of the rent owner to perform its obligations will normally depend on whether the rent payer has performed its obligations to contribute to the relevant cost.

[32] The Law Commission, n14, para 49
[33] The Law Commission, n14, para 49
[34] The Law Commission, n14, para 49

It is perhaps easy to be unduly critical of the wording of s.2(4). Significantly, the Commission felt that 'covenant supporting' or 'service charge' rentcharges should only fall outside the proposed prohibition on creating new rentcharges 'for the time being'[35], as it was then (as now) '…examining the position of positive covenants generally'[36]. It acknowledged that the exception would 'obviously fall to be reconsidered if and when any change occurs in… the underlying law'[37]. It is perhaps unreasonable to expect the Commission to have envisaged the absence of such change 40 years later.

It appears that, notwithstanding the uncertain relationship between the two parts of s.2(4), the intention behind s.2(4)(b) was to allow variable rentcharges, the sum charged then being subject to control under s.2(5). S.2(5) provides that a rentcharge for more than a nominal amount shall not be treated as an estate rentcharge 'unless it represents a payment for the performance by the rent owner of any such covenant as is mentioned in subsection 4(b) … which is reasonable in relation to that covenant'.

While the purpose of s.2(5) appears to be to control the levels of variable rentcharges, it is unclear how effective this is. There is an awkward inconsistency between 'to the extent that' in s.2(2), and 'unless' in s.2(5). 'Unless' in s.2(5) indicates that if a variable rentcharge exceeds (even slightly) what is reasonable in relation to performance by the rent owner of a relevant covenant, it would not be an estate rentcharge for the purposes of s.2(4)(b), would not fall within the exception in

[35] The Law Commission, n14, para 51
[36] The Law Commission, n14, para 51
[37] The Law Commission, n14, para 51

s.2(3)(c), and would thus be prohibited by s.2(2). The inclusion of 'to the extent that' in s.2(2) would seem to allow severance within an instrument containing a rentcharge of those aspects which fall within the exception in ss.2(3) and 2(4) and which are therefore valid from those which do not, and are void. The same flexibility does not, however, appear to be replicated in s.2(5), where it appears that the rentcharge is either reasonable in relation to the provision of the services, and it stands, or it is not, and it fails entirely.

Bright[38] argues that it would be 'reasonable' to interpret the wording consistently with the common law approach of 'blue pencilling' offending terms to leave the rentcharge as a whole valid, minus the terms that fall outside s.2(4)(b), arguing that if the invalidity of one element could render the whole rentcharge scheme void 'communal management of the development would become impossible'[39]. While the emphasis in this reasoning on practicality and utility cannot be denied, it does not of itself address the inconsistent approach of s.2(2) which appears to permit severance within an instrument of those parts which purport to create a prohibited rentcharge from those which do not, and s.2(5) which suggests that, as between individual components within a rentcharge, the opposite applies.

E) Operation in practice and regulation of the level of service charges

Service charges created via variable rentcharges differ significantly from leasehold service charges in the extent to which the level of charges can be challenged: Under

[38] Susan Bright, n2, 509
[39] Susan Bright, n2, 509

s.19 Landlord and Tenant Act 1985, the First-tier Tribunal (Property Chamber) may determine whether costs recoverable from residential leaseholders through service charges are 'reasonably incurred' and whether the services or works to which those costs relate are provided or carried out 'to a reasonable standard'. The RICS professional statement 'Service charges in commercial property'[40], effective from 1st April 2019 imposes mandatory requirements for RICS members relating to the imposition and management of commercial leasehold service charges, but not freehold charges

The absence of equivalent procedures in relation to freehold charges, has, in the few reported instances where rentcharge payers have litigated over the level of charges imposed, resulted in reliance on convoluted and ultimately unsuccessful attempts to challenge the level of charges indirectly, by challenging the validity of the estate rentcharge more broadly.

In what appears to be the first[41] of only two reported cases on the interpretation of s.2 Rentcharges Act, the Court of Appeal in *Orchard Trading Estate Management Ltd. v Johnson Security Ltd.*[42] considered a dispute regarding charges for maintaining a private sewage system on an industrial estate. Orchard, which managed the estate, had covenanted to maintain the system. Johnson and the other unit holders contributed to the cost of that maintenance via a variable service charge, secured by an estate rentcharge. The system broke down. Orchard sought to pass on the significant cost which it incurred in replacing it and of providing alternative

[40] Royal Institution of Chartered Surveyors, *Service charges in commercial property Professional Statement,* (1st edn, 2018)
[41] *Orchard Trading Estate Management Ltd v Johnson Security Ltd* [2002] EWCA Civ 406 [1]
[42] *Orchard*, n41

sewage disposal during replacement work. Johnson and other unit owners refused to pay.

Johnson appeared to use two main arguments, both unsuccessful, to attack the validity of the rentcharge. The first appears to have relied on the uncertain relationship between ss.2(2) and 2(5), and to argue that the inclusion within the items of chargeable expenditure of items (in this case, rates on the shared roadways, the service area and the sewage works) which did not directly benefit Orchard's land, and which therefore fell outside s.2(4)(b), rendered the rentcharge invalid. The court, perhaps relying unduly on its finding that no such rates were in fact charged, found that such rates would fall within s.2(4)(b). Peter Gibson LJ concluded that as such rates would fall within s.2(4)(b)[43], the 'important question' of whether their inclusion would render a rentcharge invalid 'was best…decided in a case where it was not a hypothetical issue'[44]. He acknowledged that Orchard's submission that offending items could be severed from the rest turned on the inclusion within s.2(2) of the words 'to the extent that'. What appears not to have been addressed is that s.2(2) appears to allow for the severance *within an instrument* of a prohibited rentcharge from its other provisions (for example, those transferring ownership). The failure to consider whether individual components of a rentcharge can be severed from each other (and the wording of s.2(5) would suggest that they cannot) is unfortunate.

Johnson's second argument was that the sum which Orchard sought to recover was unreasonable in relation to the covenant[45], and that as s.2(5) required sums payable

[43] *Orchard*, n41 [26]-[27]
[44] *Orchard*, n41 [27]
[45] *Orchard*, n41 [7]

to the rent owner to be reasonable, that lack of reasonableness meant that the rentcharge fell outside s.2(3).

Dismissing this argument, and with little evident sympathy for Johnson's position, Peter Gibson LJ was keen to emphasise that the appeal 'was concerned not with whether any item charged was reasonable in amount but with the validity of the rentcharge'[46]. This disregards the high likelihood that the dispute *did* essentially concern the level of charges imposed (since it is reasonable to suppose that Johnson might have agreed to pay an increased service charge had the increase been smaller) and that the attack by Johnson on the validity of the rentcharge was a natural consequence of the absence of any other means by which the level of charges could be challenged.

The discussion in *Orchard* of s.2(5) provides little assistance either to rent owners or rent payers as to its effect. Peter Gibson LJ noted that s.2(5) is an anti-avoidance provision 'designed to prevent a requirement by the rent owner that the [rent payer] should make a payment unrelated or disproportionate to the covenants within 2(4)(b)'[47]. He then, curiously, cited as an example of an arrangement to which s.2(5) would apply, the imposition of 'a *fixed* [emphasis added] sum…which… far [exceeded] what would be reasonable for the performance of the covenant'[48] (notwithstanding the evident intention that s.2(4)(b) should apply to variable rentcharges), and distinguished this from the present case of 'a variable rentcharge which is measured and limited by the expenditure by Orchard in the performance of the covenants'[49]. While he emphasised, in accordance with the wording of s.2(4),

[46] *Orchard*, n41 [29]
[47] *Orchard*, n41 [29]
[48] *Orchard*, n41 [29]
[49] *Orchard*, n41 [29]

the reasonableness of the cost to the rent owner of performing the covenants, rather than the cost then charged to the rent payer (a distinction which rent payers are unlikely readily to accept), he appears to have assumed that because the rentcharge was variable, and Orchard could demonstrate the expenditure incurred in complying with its covenants, the level of that expenditure was by definition reasonable. Little consideration appears to have been given to the possibility that Orchard could have satisfactorily complied with its covenants at a lower cost.

From Johnson's perspective, the decision appears harsh. The total expenditure recoverable from the unit holders in 1995 was £18,470[50]. In 1997, following the breakdown of the sewage system, that figure rose to £182,791. The harshness is compounded by the fact that Orchard had originally sought to recover an additional £30,000 in fines and costs imposed on it for illegally discharging effluent as a result of the breakdown. The report reveals only that Orchard had accepted (presumably in pre-trial correspondence) that the fine and costs could not be passed on to the unit owners[51]. Evidently both Orchard and the court recognised that not all the expenditure incurred could be passed on to Johnson and the other unit holders, and it is not immediately clear why scope for reducing the charges further was not explored.

The uncertainty surrounding s.2(5) and its relationship with the previous subsections remains, and is perhaps increased, by the decision in *Smith Brothers Farms Limited v The Canwell Estate Company Limited*[52]. Smith Brothers sought to challenge a

[50] *Orchard*, n41 [5]
[51] *Orchard*, n41 [5]
[52] *Smith Brothers Farms Limited v The Canwell Estate Company Limited* [2012] EWCA Civ 237

claim for charges imposed to maintain roads on an industrial estate. It argued that as it had no rights to use some roads in respect of which the charges were made, it derived no direct benefit from aspects of the charge. The court dismissed this on the basis that indirect benefit (which was found to exist on the facts) was sufficient for the purposes of s.2(4)(b).

Perhaps more surprising is how the court addressed another of Smith Brothers' arguments, which was that, in addition to being required to contribute to the maintenance of roads it had no right to use, it was also required to pay 90% of the cost of maintaining a road which it had a shared right to use. It argued, using s.2(5), that the imposition of this second charge was unreasonable, and the estate rentcharge therefore failed. Mummery LJ noted that the emphasis in s.2(4)(b) was not on the level of benefit to the rent payer, but on the cost to the rent owner of providing the services[53], and following the reasoning from *Orchard,* found unequivocally that 'it does not follow that the validity of a rentcharge depends on the reasonableness of the amount calculated … for the service charge'[54]. He stated further that if an unreasonable payment is sought by the rent owner, 'the estate rentcharge does not automatically cease to be an estate rentcharge or cease to be valid: it simply becomes unavailable to the rent owner as a means of recovering a particular contribution to costs that are not reasonable in relation to the performance of the covenant'[55].

It is argued that this conclusion is neither 'simple' nor does it reflect what s.2(5) says. By implication it suggests that severance between different items in respect of which

[53] *Smith,* n52 [36]
[54] *Smith,* n52 [60]
[55] *Smith,* n52 [60]

charges are made is possible, even though s.2(5), when construed strictly, appears to state the opposite. Nor is there any explanation of precisely how or when the estate rentcharge would simultaneously remain valid and 'become unavailable', or what the effect of this would be in practice.

F) Lenders' New Requirements

Given the significant conceptual and practical difficulties which estate rentcharges present, and in particular their inherent reliance on the right of entry, it is perhaps unsurprising that their acceptablility to lenders, keen to protect their security, is doubtful. Practical Conveyancing Precedents explanatory notes state unequivocally that the imposition of a rentcharge with an annexed right of entry 'might be unacceptable to lenders, and indeed buyers'[56].

It is argued that the lenders' new requirements, which appear to be directed at reducing the circumstances in which rights of entry can, or are likely to be exercised might only partially address their entirely legitimate concerns. Barclays' new requirements (effective from 19th January 2019) are used as an example: They state[57] that where a rentcharge (not limited to estate rentcharges) is payable, it will be acceptable if one of three requirements is satisfied. These are:

1. That the rent charge owner is a management company owned by the residents of a private freehold development (as shareholders), or
2. That the statutory remedies in s.121 LPA 1925 have been expressly excluded in the rent charge instrument, or

[56] Aldridge, n21, Forms 1/688
[57] UK Finance, n1, para 5.15.2a

3. The rent charge instrument contains notification to the mortgagee of at least 21 prior to any enforcement action by the rent charge owner.

These amendments present several practical difficulties: The requirement that the rentcharge owner be a company limited by shares, and that the residents of the development be shareholders, appears to disregard the possibility (implemented to avoid cumbersome issues of shares and subsequent share transfers on sale) of it being limited by guarantee. Nor is it immediately obvious how the status of the rent owner has any direct bearing on the exercise of the right of entry, unless it is simply that a company of which the rent payer is a shareholder is for practical purposes less likely to exercise the right of entry against it.

The second option, that of excluding the statutory remedies in s.121(5) LPA from the rentcharge instrument, is in theory feasible, and indeed s.121 permits this. But this would necessitate (if indeed the rentcharge owner, who is likely to want all units to have common documentation, agrees at all) a costly and time consuming deed of variation. More significantly, excluding the statutory remedies would still leave any expressly agreed right of entry, with its uncertain and unexplained application directly to positive covenants, unamended.

In relation to the third requirement, it is difficult to identify what incentive a rentcharge owner would have for agreeing to give a mortgagee 21 days' notice of enforcement proceedings. Even if it agreed, the necessary changes to the rentcharge instrument (in many cases the Land Registry transfer) would be costly, and to the rentcharge owner, unappealing.

These changes both recognise that estate rentcharges are sufficiently widespread to justify their introduction, and rightly recognise the risk that they pose to lenders.

They do, however, appear to complicate further what is already a conceptually and practically difficult area. More significantly, by attempting to restrict the exercise the right of entry, lenders would appear to be disregarding its purpose. By partially depriving the estate rentcharge of its primary enforcement method, lenders appear to be leaving the justifiable aim of enforcing positive covenants, the performance of which is vital to the proper operation of the estate (and to the maintenance of the value of a lender's security), inadequately supported.

Conclusions and recommendations

The conclusion that estate rentcharges 'lie uncomfortably between ancient obscurity and modern law reform'[58] appears inescapable. The practice of using them to enforce positive covenants may be viewed as owing more to reluctant pragmatism and to a degree of optimism by rent owners (perhaps justified by the relative scarcity of recorded disputes) than to clear legal principle. Their ready use, in an attempt to reconcile the relative popularity of freehold ownership with the inability adequately to enforce freehold positive covenants, can easily demonstrate incomplete appreciation of their peculiarity and complexity. Their heavy dependence on the inclusion of rights of entry, their regulation by legislation which appears was intended to be temporary, and their relative inability to protect freehold householders against unreasonable charges do little to commend them.

Existing and proposed reforms from the Government and lenders focus on specific areas of concern. Following public demand for regulation, the Government has

[58] G L Newsom, *Preston & Newsom's Restrictive Covenants affecting Freehold Land* (9th edn, Sweet & Maxwell, 1998) 155

commited ‘to give freeholders on private…estates equivalent rights to leaseholders to challenge the reasonableness of estate rentcharges (replicating relevant provisions in the Landlord and Tenant Act 1985)’[59]. Lenders have sought to regulate the aspect of rentcharges which most concerns them, which is the potential exercise of rights of entry. The effect of their new requirements remains to be seen.

Of these two areas, the regulation of the level of service charges is easier to address. An alternative to extending existing leasehold protections to freeholders might be to modify the Rentcharges Act by amending s.2(4)(b) to require that both the nature and the level of costs incurred must be reasonable. Altering the reference to ‘A rentcharge’ in s.2(5) to ‘A rentcharge or a payment forming part of a rentcharge’ could allow items of expenditure falling outside s.2(4)(b), or unreasonable costs incurred by the rent owner on permitted items of expenditure to be severed.

The reliance of estate rentcharges on rights of entry, which are simultaneously essential to their operation and wholly unappealing, is harder to resolve. Any attempt, statutory or otherwise, to regulate or limit their imposition or use increases the risk that positive covenants remain unperformed with adverse consequences for buyers and their lenders.

For this reason, practitioners might reasonably avoid estate rentcharges altogether, or at least use them sparingly and with proper regard for their conceptual and practical weaknesses. More use might be made of the conceptually simpler, albeit narrow, doctrine in *Halsall v Brizzell*[60], due care being taken to ensure a genuine connection between the right enjoyed and the contribution sought. For items from which an owner derives no direct benefit and has no right to use, practitioners might

[59] House of Commons Library, n8, 4
[60] *Halsall v Brizzell* [1957] 1 All ER 371

place Restrictions on the relevant titles requiring new covenants to be entered into on each disposal. If these methods are felt to be unsatisfactory, the wider use of Commonhold, or the introduction of Land Obligations, while not affecting existing estate rentcharges, might constitute the beginning of an end to the ‘temporary reprieve’ granted more than a generation ago.