

JUDGMENT : Mr Justice Sales : Chancery. 28th November 2008

1. This is an application made under section 68 of the Arbitration Act 1996 for an order remitting an award dated 20 February 2008 made by Mr D.C. Stanger ("the Arbitrator") in respect of a rent review clause in a lease. The Claimant, Metropolitan Property Realizations Limited ("Metropolitan") is the tenant under that lease. The Defendant, Atmore Investments Limited ("Atmore"), is the landlord.
2. The relevant lease is an under-lease dated 29 September 1964 granted for a period of about 99 years. The property to which it relates comprises a small parade of shop units with residential flats on the floor above them, located in Partington Street, Failsworth. The lease is a full repairing and insuring lease. Clause 1(b) provides for rent reviews to take place every 21 years.
3. The second rent review fell due in September 2006. Clause 1(d) of the lease sets out the formula to be applied on each review in the following terms:-

"(d) *"the yearly rent value of the demised premises" as at the last quarter day but one before the end of a rent period shall mean the amount agreed between the Landlord and the Tenant as the yearly rent value of the demised premises as at such day or failing agreement the amount determined as the yearly rent value of the demised premises at such day by an arbitrator to be nominated by the President for the time being of the Royal Institution of Chartered Surveyors on the application of the Landlord made before but not more than one quarter before the beginning of the next succeeding rent period and so that in the case of any such arbitration the amount to be determined by the arbitrator shall be the amount which shall in his opinion represent a fair yearly rent for the demised premises at the relevant date having regard to rent values then current for property let without a premium with vacant possession and to the provisions of this Lease (other than the rent hereby reserved)"*

The relevant date referred to in relation to the present case was 24 June 2006. The parties were unable to agree the amount of the yearly rent value, so the question of the amount of a fair yearly rent was referred to arbitration.

4. The lease provides in clause 2 that the rent payable should be the greater of:-
"(i) a rent equal to the rent payable during the last preceding rent period: and
(ii) a rent equal to six elevenths of the yearly rent value of the demised premises as at the last quarter day but one before the end of the last preceding rent period."

It is common ground that the assessment under (ii) was to involve the calculation of the fair yearly rent of the demised premises as at 24 June 2006, with the application of the six elevenths formula to take place in relation to the figure so determined. In other words, it was common ground that in assessing the fair yearly rent of the demised premises one should ignore the six elevenths calculation.

5. The arbitration was conducted by reference to written materials alone. For Metropolitan, the written submissions were prepared by Mr Simon Burbidge, a chartered surveyor. Atmore's written submissions were prepared by Mr Peter Owen, who also is a chartered surveyor.
6. The submissions put in by Mr Burbidge for Metropolitan followed advice provided by leading counsel as to the proper approach which should be adopted to valuation of a lease of this kind. Metropolitan was represented at the hearing before me by different leading counsel, Mr Fetherstonhaugh QC. He made it clear in his submissions that Metropolitan did not now seek to contend that the method of valuation proposed in the previous counsel's opinion and adopted by Mr Burbidge is correct. That method involved discounting the relevance to the calculation of a fair yearly rent of the rental income which could be achieved upon sub-letting the units in the demised premises. In his written submissions at paragraphs 6.2 to 6.4 Mr Burbidge submitted:-

"6.2 *The simplistic way to look at this matter is to apply a market rental figure to each of the component parts of the property to get a total rent and then take 6/11 of that figure as being the rent applicable however the Leading Counsel's Opinion clearly states that that is not the correct approach. We are to assume that the whole development is available to let on the open market with vacant possession for a term of 57 years with the remaining terms being as per the subject lease. The rent payable will then be 6/11 of that figure.*

6.3 *The question this raises is having regard to the nature of the development, the income likely to be received from sub-tenants, the costs liabilities under the lease, shopping patterns at the time of the review and general demand for units in such a location would there be a market for such a lease at a rental in excess of that already paid?*

6.4 *My view is that there would not. The evidence of the cost/income spreadsheet shows minimal benefit for a great deal of effort. With the opening of the 24 hour Tesco close by it is only going to become harder to attract sub-tenants for the commercial parts in the future and harder for them to stay in business. ..."*

He concluded at paragraph 6.10:-

"6.10 *A 57 lease term on a property of this nature in such a location is inconceivable in the current market. In my opinion the only way a theoretical Tenant would be persuaded to take a 57 year lease of a property of this nature in such a location would be on a peppercorn basis.*"

Mr Burbidge put forward no alternative argument as to what the proper position should be if the Arbitrator did not accept the fundamental point of principle he was putting forward as to the approach to valuation to be adopted, and preferred instead the approach put forward by Atmore.

7. Mr Owen, for Atmore, presented a case which started from analysis of the rental income which on the evidence available he thought could be identified as obtainable for each of the units within the parade of shops and for

each of the residential flats. Taking account of rents which had in fact been achieved for such units, he concluded that the yearly rental value of the shops would be £5,000 per annum for each standard unit and that the rental value for the residential flats would be £3,600 per annum each, with some associated garages. He then aggregated these figures to give an overall rental income figure for the whole of the demised premises.

8. Mr Owen made three adjustments to the figure given on this basis of calculation. First, he considered that a deduction should be made for a management charge. At paragraph 5.3.6 of his submissions he said:-

"5.3.6 Management Charge

5.3.6.1 ... In a building with multiple occupancy, it is normal to make a discount for management. It is also quite usual to make a discount from sub-let income when an occupier sub-lets part of a larger demise.

5.3.6.2 Neither of these instances is entirely similar to the subject circumstances but I see there a principle which applies to whomsoever collects the rent.

5.3.6.3 With regard to the amount of that management charge, I refer you to the attached memo from my colleague, Mark Hopley, who is the Associate Director in charge of the Management Department at Legat Owen. You will see that in his view a typical charge would be 5% of the rents collected, although he does point out that some residential agents are charging 10%. He also refers to the RICS's preference and Code in this regard and gives his opinion that the likely management fees, involved with a parade of this nature, would be in the order of £10,000 per annum.

5.3.6.4 I am therefore adopting that in my calculation. I see it as good first hand evidence and it shows, in percentage terms, a charge of some 9% which fits in with Mr Hopley's general observations."

9. Second, Mr Owen allowed for a deduction in respect of an estimate of the extent to which the shop units and residential units might be unlet, and so empty or void, during the 21-year period for which the new rent would apply. He concluded that the void rate for the shop units would be of the order of 10% over the relevant period. For the residential units, he concluded that the void rate would be 15%.
10. Third, Mr Owen made an adjustment in favour of taking account of the fact that the new rent would, once established, last for the extended period of 21 years. His view was that it was necessary to make an adjustment for the increasing imbalance from the original bargain as the term progresses. Accordingly, he adopted an approach (which he described as being common among practitioners) of making an addition of 1% for every year over five, giving a total adjustment of 16%.
11. He set out his calculation in section 6 of his report, headed "The Yearly Rent Value", as follows:-

"Total yearly rent value for shops	£ 78,450
Flats and maisonettes	£ 42,720
Garages	£ 1,400
	£122,570
Add 16% for 21 year rent review pattern	£ 19,611
Deduct management cost	(£10,000)
Deduct shop voids @ 10%	(£ 7,845)
Deduct residential & garage voids @ 15%	(£ 6,618)
	£117,718
	Say £118,000 per annum"

12. His calculation therefore proceeded on the basis of what a notional tenant of the whole demised premises would receive by way of rental income from sub-lets of the shop units and the residential units. The adjustments that he made were to reflect the real monetary value of that stream of rental income in the hands of that notional tenant. Having established the value of that stream of rental income in the hands of the notional tenant, Mr Owen then equated that figure with what he contended should be regarded as the fair yearly rent of the demised premises for the purposes of clauses 1 and 2 of the lease. However, the fair yearly rent which clause 1(d) of the lease required him to calculate was the rent that would be payable by the notional tenant to the landlord. On Mr Owen's calculation, equating the income for the notional tenant from sub-letting the units with what that tenant would pay the landlord, the notional tenant under the fair rent calculation would derive no benefit for itself from taking the lease. It was difficult, therefore, to see why any prospective tenant would actually wish to take on the lease on these terms. This flaw in Mr Owen's methodology, however, was not one that was pointed out by Mr Burbidge for Metropolitan.
13. The Arbitrator in his reasoned award reviewed the submissions made by Mr Burbidge for Metropolitan and by Mr Owen for Atmore. He decisively rejected Mr Burbidge's submission discounting the assistance to be derived from looking at the rental values of the individual units and preferred the submission of Mr Owen to the effect

that those rental values should form the basis of the calculation of the fair yearly rent. No criticism is made of the Arbitrator on what was, as the parties' submissions had been presented to him, the central point which was in issue between the parties. The Arbitrator's conclusion was to agree with Mr Owen "that the occupational leases provide the best evidence for the market rents for shops and flats". He went on to say:-

"I do not share [Mr Burbidge's] view that there is no market for a lease of this nature. I agree that the lease is unusual, but like [Mr Owen] have no doubt that if there is a profit rent to be made for the next 57 years, there will be investors in the market wanting that opportunity. Having established that I find [Mr Owen's] approach to be correct, I will now look at his valuation in detail."

14. Reviewing Mr Owen's calculation in detail, the Arbitrator accepted all of Mr Owen's adjustments, noting that there was "little opposition" from Mr Burbidge to these adjustments. He concluded that the yearly rent value for the demised premises should be £118,000 per annum, accepting Mr Owen's submission in that regard.
15. The criticism that Mr Fetherstonhaugh now makes of the Arbitrator's reasoning is that on the approach that he adopted, based on Mr Owen's submissions, the calculation set out and accepted by him allowed for no element of profit in respect of the lease for the notional tenant. I did at one stage during the hearing wonder whether the management charge might be said to include some potential profit element for the notional tenant, if it decided to manage the properties for itself. However, Mr Fetherstonhaugh rightly points out that in the arbitration award the management element is treated as a "charge" for the notional tenant and is described as "a deduction of £10,000 for the tenant's management costs". Mr Clark for Atmore was unable to point to any profit element for the notional tenant in the Arbitrator's calculation. It is therefore difficult to conclude that the Arbitrator had formed the view that there would be a profit element for the notional tenant to be found within the management charge adjustment in his calculation.
16. Accordingly, on this issue regarding the basis for the Arbitrator's reasoning, I accept Mr Fetherstonhaugh's submission. It appears to me that on the submissions and calculation put forward by Mr Owen, which were adopted into the reasoning and calculation of the Arbitrator, there is no element of profit for the notional tenant taking a lease of the demised premises. The yearly rent of £118,000 determined to be payable by that tenant to the landlord simply equals the monetary value of the sub-lettings to be made by the tenant.
17. Section 68 of the Arbitration Act 1996 provides in relevant part as follows:

"Challenging the award: serious irregularity.

68.(1) A party to arbitral proceedings may (upon notice to the other parties and to the tribunal) apply to the court challenging an award in the proceedings on the ground of serious irregularity affecting the tribunal, the proceedings or the award.

A party may lose the right to object (see section 73) and the right to apply is subject to the restrictions in section 70(2) and (3).

(2) Serious irregularity means an irregularity of one or more of the following kinds which the court considers has caused or will cause substantial injustice to the applicant —

...

(d) failure by the tribunal to deal with all the issues that were put to it ...

(3) If there is shown to be serious irregularity affecting the tribunal, the proceedings or the award, the court may—

(a) remit the award to the tribunal, in whole or in part, for reconsideration,

(b) set the award aside in whole or in part, or

(c) declare the award to be of no effect, in whole or in part. "

18. As indicated by the last part of section 68(1), there are restrictions upon the right of application to the court to set aside an arbitration award. Section 70(2)(b) of the 1996 Act provides that no application may be made to the Court under section 68 if the applicant has not first exhausted any available recourse under section 57 to the arbitrator to correct the award. Section 57 of the Act provides:

"Correction of award or additional award.

57.(1) The parties are free to agree on the powers of the tribunal to correct an award or make an additional award.

(2) If or to the extent there is no such agreement, the following provisions apply.

(3) The tribunal may on its own initiative or on the application of a party—

(a) correct an award so as to remove any clerical mistake or error arising from an accidental slip or omission or clarify or remove any ambiguity in the award, or

(b) make an additional award in respect of any claim (including a claim for interest or costs) which was presented to the tribunal but was not dealt with in the award.

These powers shall not be exercised without first affording the other parties a reasonable opportunity to make representations to the tribunal.

(4) Any application for the exercise of those powers must be made within 28 days of the date of the award or such longer period as the parties may agree.

(5) Any correction of an award shall be made within 28 days of the date the application was received by the tribunal or, where the correction is made by the tribunal on its own initiative, within 28 days of the date of the award or, in either case, such longer period as the parties may agree.

(6) Any additional award shall be made within 56 days of the date of the original award or such longer period as the parties may agree.

(7) Any correction of an award shall form part of the award."

19. Mr Clark for Atmore emphasises that the particular criticism of Mr Owen's calculation which Mr Fetherstonhaugh now advances for Metropolitan, to the effect that it does not allow for any profit element for the notional tenant, was not put forward in the submissions for Metropolitan in the arbitration, even as a fall-back, alternative case. Mr Clark submits that in these circumstances it cannot be said that there has been any "serious irregularity" on the part of the Arbitrator resulting in "substantial injustice" to Metropolitan. He submits that as a matter of general approach the court should strive to uphold arbitration awards; that "it is only in those cases where it can be said that what has happened is so far removed from what could reasonably be expected of the arbitral process" that the court may intervene; and that under section 68(2)(d) this will be "where the arbitral tribunal has not dealt at all with the case of a party so that substantial injustice has resulted": see **Fidelity Management SA v Myriad International Holdings BV** [2005] 2 All ER (Comm) 312 at [5] to [10], in which Morison J reviews the principles applicable and relevant authorities. There is a high threshold which must be crossed before a court will be justified in intervening in an arbitration award under section 68. In the present case Mr Clark says that that threshold has not been crossed. Metropolitan lost on its one and only argument in the arbitration (as to which no criticism of the Arbitrator is suggested by Metropolitan) and it did not present an alternative case that the calculation put forward by Mr Owen should not be accepted because it allowed for no profit element for a notional tenant. Therefore, Mr Clark submitted, the Arbitrator did sufficiently deal with the cases put forward on each side in the arbitration and his calculation of the fair yearly rent does not involve any error falling within the scope of section 68(2)(d).
20. Mr Fetherstonhaugh submitted that failure to deal with a substantial issue between the parties will fall within section 68(2)(d), and that this is what had happened in this case. He relied upon the decision of the Court of Appeal in **Checkpoint Limited v Strathclyde Pension Fund** [2003] 1 EGLR 1 at paragraph 58 per Ward LJ:-
"[58] ... The court should not make its own guess at the rental figure and make a comparison with the amount awarded. Rather, the court should try to assess how the tenant would have conducted his case but for the procedural irregularity. It is the denial of the fair hearing, to summarise procedural irregularity, that must be shown to have caused a substantial injustice. A technical irregularity may not. The failure to deal with a substantial issue probably will. ..."
21. I do not accept Mr Clark's submission that the requirements in section 68(2)(d) have not been satisfied so as to justify the Court's intervention in this case. The basic issue put to the Arbitrator for determination was the question of the fair yearly rent as calculated in accordance with clause 1(d) of the lease. That issue required the Arbitrator to determine the notional market rent which a notional tenant would pay in respect of the demised premises for the remaining term of the lease. The Court should not read an arbitration award "with a meticulous legal eye endeavouring to pick holes, inconsistencies and faults ... and with the objective of upsetting or frustrating the process of arbitration" (**Zermalt Holdings SA v Nu-Life Upholstery Repairs Ltd** [1985] 2 EGLR 14, per Bingham J). Nonetheless, if there is a glaring illogicality contained in the central reasoning in an award, the Court may intervene. In my view, even though Metropolitan did not present distinct submissions in the arbitration on the question of a flaw in Mr Owen's calculation, it was still incumbent on the Arbitrator to reason through his award in a logical way, satisfying himself that the calculation which he adopted into his award was coherent in light of the commercial approach which he decided should be applied and sufficient to answer the basic issue which he had to resolve. I consider that this is what was reasonably to be expected of the arbitral process in this case.
22. This was in fact the way in which the Arbitrator sought to approach his task. He did not simply adopt Mr Owen's calculation, but examined and decided upon each element in it in the course of reasoning through his own award. The Arbitrator explained the commercial logic which he thought appropriate to provide the basis for the calculation of the fair yearly rent in the passage of his award quoted at paragraph [13] above. His approach assumed that a notional tenant would take a relevant notional lease at a rate which included a profit element for itself. Unfortunately, however, it is clear that the calculation the Arbitrator then carried out to arrive at the fair yearly rent did not in fact include any element of profit for the notional tenant. He failed to identify the amount of the notional tenant's profit which was appropriate and failed to allow for an element of such profit in the calculation of fair yearly rent, which he had himself identified as a relevant factor to be taken into account. For that reason, I consider that the Arbitrator's award was obviously flawed as a matter of the commercial logic which he himself decided should be applied. It cannot be regarded as a rationally sustainable resolution of, or dealing with, the basic issue which he had to determine.
23. Section 68(2)(d) is "designed to cover those issues the determination of which is essential to a decision on the claims or specific defences raised in the course of the reference": **World Trade Corp. Ltd v C Czarnikow Sugar Ltd** [2004] 2 All ER (Comm) 813 at [16], cited in **Fidelity Management v Myriad International Holdings** at [9(1)]. In my judgment, the Arbitrator failed to determine and allow for the notional tenant's profit element, which was on his reasoning a matter essential to his decision on the issue he had to resolve. This failure by the Arbitrator fell within section 68(2)(d), in that it amounted to a "serious irregularity" by virtue of which he failed to deal with the basic issue which he had to decide. It has caused substantial injustice, in that Metropolitan has been deprived of the benefit of a rationally sustainable arbitral award, and the award which has been made is flawed in a manner which may cause Metropolitan substantial financial detriment in having to pay an excessive amount of rent under the lease for a very extended period of time.

24. At the hearing, Mr Clark made a further submission, that Metropolitan should have applied to the Arbitrator under section 57 of the 1996 Act to correct or clarify his award, and that having failed to do so it was prevented by operation of section 70(2)(b) of the 1996 Act from applying to the Court under section 68. Metropolitan had in its pleading and evidence made clear its view that there was no avenue of relief available under section 57, so section 70(2)(b) had no application. In my judgment, that is right. The error in the arbitration award was clearly not a typographical error, amenable to correction under the part of section 57 which corresponds with the usual slip rule applicable to court judgments. Nor, in my view, was the error in the award of which Metropolitan wished to complain a matter of an ambiguity or lack of clarity in the award. The award made was clear, but it was founded upon an error of reasoning. Therefore, I do not consider that Metropolitan is debarred from applying to the Court under section 68.
25. For these reasons, Metropolitan's claim under section 68(2)(d) succeeds. The relief claimed by Metropolitan is remission to the Arbitrator for a re-determination by him, limited to determination of the appropriate element of profit for a notional tenant to be included in the calculation of fair yearly rent, and for that element to be taken into account in the calculation made in the existing award. I so order.

Mr Guy Fetherstonhaugh QC (instructed by McGrigors) for the Claimant
Mr Wayne Clark (instructed by Mace & Jones) for the Defendant