Dear Edward,

Re. Modern Limited Duration Tenancies – explanatory material for Scottish Statutory Instruments

I will be appearing before your Committee on 1 November to discuss 3 Scottish Statutory Instruments associated with modern limited duration tenancies ("MLDTs"). These are SSI 2017/299, SSI 2017/300 and an instrument laid in draft which is subject to the affirmative procedure. I am aware that some of this legislation is complex and therefore, in advance of that meeting, and in order to aid our discussions, I would like to take the opportunity to provide you and your Committee members with some additional information about these SSIs.

This informal note is meant to be read in conjunction with the explanatory notes and policy notes for each of the instruments.

The Agricultural Holdings Legislation Review Group recommended the creation of a new tenancy type which is more suitable for 21st century farming. This is delivered by the MLDT provisions contained in Chapter 1 of Part 10 of the Land Reform (Scotland) Act 2016 (the 2016 Act), together with some other relevant provisions of that Act. Stakeholders have generally been supportive of this policy. The MLDT replaces the existing Limited Duration Tenancy ("LDT") set out in the Agricultural Holdings (Scotland) Act 2003 (the 2003 Act). LDTs in existence immediately before the coming into force of these Regulations will continue to exist. The 2016 Act establishes MLDTs by inserting new provisions into the Agricultural Holdings (Scotland) Act 2003 (the 2003 Act), meaning that MLDTs will be created under the 2003 Act.

There are 3 Scottish Statutory Instruments associated with the introduction of MLDTs, which are all due to come into force on 30 November – 1 affirmative, 1 negative (SSI 2017/300) and 1 with no procedure (SSI 2017/299). SSI 2017/299 commences a number of provisions of the 2016 Act in order to introduce MLDTs. A large part of all three instruments are transitory, savings, supplementary and consequential provisions designed to ensure that the move from LDTs to MLDTs is smooth and to pick up all the relevant references in other pieces of legislation. Stakeholders have not raised any concerns with us about this process.
However, SSI 2017/300 contains provision as to which tenants under a lease constituting an MLDT are new entrants to farming for the purposes of section 5B of the 2003 Act. Section 5B is inserted by section 85(3) of the 2016 Act, which is being commenced by SSI 2017/299. The effect of being a new entrant to farming is that the lease may contain a five year break clause. The relevant provisions of SSI 2017/300 were somewhat more complicated to formulate and required significant consultation with our stakeholders.

Attracting new entrants into agriculture has been identified as one of the most serious issues affecting the industry. Of particular concern to landlords are the risks associated with untested new entrants. Many landlords may be reluctant to enter into a long term business contract with someone who has no track record in farming. To address this issue in relation to MLDTs, the new provisions of the 2003 Act (inserted by the 2016 Act) provide that where the tenant is a new entrant to farming, parties may include a break clause to allow the lease to be terminated after 5 years.

The new provisions inserted into the 2003 Act provide the Scottish Ministers with regulation making powers to make provision as to who is and is not a new entrant to farming for these purposes. There are a number of current definitions falling under the umbrella of ‘new entrant’ used and understood by the industry, for instance, for the purposes of administering SRDP grants and the basic payments scheme. When developing the definition of a new entrant for the MLDT regulations, Scottish Government officials worked closely with stakeholders – NFUS, SLE, STFA, RICS and SAAVA – to identify what definition would be most appropriate. Stakeholders were keen for something similar to the definition of a person commencing their agricultural activity contained in EU Regulation 1307/2013, which is:

‘farmers commencing their agricultural activity’ means natural or legal persons who, in the five years preceding the start of the agricultural activity, did not have any agricultural activity in their own name and at their own risk or did not have the control of a legal person exercising an agricultural activity. In the case of a legal person, the natural person or persons in control of the legal person must not have had any agricultural activity in their own name and at their own risk or must not have had the control of a legal person exercising an agricultural activity in the five years preceding the start of the agricultural activity by the legal person’

Working from this, stakeholders have contributed to the final definition of new entrant for MLDTs, as contained in SSI 2017/300, and we have endeavoured to take on board all of their comments. Officials shared a draft copy of the relevant provisions with them before it was laid to ensure that they were content, and are not aware of any outstanding major concerns.

The initial step of determining whether or not the tenant under the lease (being a natural or legal person) is a new entrant is relatively straightforward – so long as the tenant does not meet any of the criteria under regulation 3(3) they may be a new entrant. Where there is a shared lease, and where the majority of the tenants (i.e. 50% or more) would fall within the definition of a new entrant (i.e. if the individual tenants were to have been tenants on their own, they would not meet the criteria of regulation 3(3)), then the tenants can be considered new entrants (regulation 4). A shared lease is where the tenants are tenants in common or are joint tenants.

Complications arise when the tenant is a legal person. That is because, while that tenant might qualify as a new entrant (i.e. regulation 3(3) does not apply to that tenant), a secondary stage of consideration needs to take place to determine the ‘new entrant status’ of the person(s) who control that tenant. This is to help limit the extent to which separate
legal personality of the tenant can be used as a means to obtain ‘new entrant status’. In turn that has required officials considering what it means to have ‘control’ of a legal person in this context. This is also relevant for determining whether regulation 3(3)(d) applies to a tenant – that is where the tenant has had control of a legal person and where regulation 3(3) would apply to that legal person were it the tenant. What is meant by control in the context of the definition of farmers commencing their agricultural activity in EU Regulation 1307/2013 is not clear, and in any case, a definition of control is required which suits this specific policy context.

The definition of control which has been applied focuses on the ability to control the activities of the legal person, rather than controlling the profits and capital of the legal person. It focuses more on whether a person can control the decisions and the way that the legal entity makes decisions (and consequently, how the tenancy is farmed) rather than who gets the benefit of the profits of the farming business. The definition takes the provisions on persons with significant control contained in the Companies Act 2006 (and associated secondary legislation) as inspiration. Defining control does add complexity to the instrument. However, stakeholders understood the need for this to be incorporated.

Under regulation 3(4), where the tenant is a legal person and one person (natural or legal) has control of that legal person (within the meaning of regulation 5), then the ‘new entrant status’ of the legal person is determined by looking at the ‘new entrant status’ of the person with control. To do that we look at whether or not the person with control would be a new entrant if that person were themselves the tenant i.e. whether or not regulation 3(3) would apply to that person. If the person with control of the tenant is a new entrant, then the tenant is also a new entrant. That is, of course, assuming that the tenant is not already excluded by the application of regulation 3(3) to that tenant. Consideration under regulation 3(4) only needs to take place where the legal person tenant has already ‘passed’ regulation 3(3).

If the legal person tenant ‘passes’ regulation 3(3), and consideration under regulation 3(4) reveals that no one person has control of the tenant, then consideration takes place under regulation 3(5). Under that provision, the decision hinges around the status of groupings of people who between them can be said to have control. Essentially where each of the persons who between them can be said to exercise the markers of control would be defined as new entrants under regulation 3(3) if those persons were themselves the tenant, then the legal person tenant can be considered a new entrant.

We have attempted to summarise the process of determining a new entrant for the purposes of 5B in a diagram, which is at Annex A.

Officials and stakeholders are conscious that it would be possible for someone determined to circumvent the provisions to find a way to do so, e.g. by falsely declaring their own status, or disguising their interest in a legal person. However, the Scottish Government view is that any gain from doing so would be extremely limited. The legislation only provides that the lease may contain a break clause – so the landlord is not obliged to offer it, even if the tenant is a new entrant to farming and vice versa, the tenant is not obliged to accept a break clause even if the tenant is a new entrant to farming. Therefore it is considered that adding more complexity to the instrument via anti-avoidance measures would be disproportionate in terms of these provisions.

Officials are also conscious of wider stakeholder concern over how this relates to another part of the 2016 Act - Chapter 7 of Part 10 (Relinquishment and assignation of 1991 Act tenancies) - which also introduces regulation making powers to define new entrants for the purposes of that section. The relevant provisions have not yet been brought into force. The
ideal scenario in terms of consistency would be to apply the same definition of new entrants for both sections of the 2016 Act. However, Chapter 7 has a different purpose and it is considered very likely that a different definition will be required. Although the definition of new entrant agreed for MLDTs may be used as the basis of discussions for Chapter 7, when developing secondary legislation for that Chapter officials will need to re-visit the suitability of applying the same definition for both sections to ensure that it is fit for purpose.

A further point to note about SSI 2017/300 is that regulation 3(7) sets out categories of person who are not to be considered as falling within the meaning of tenant in regulation 3(3). This is because the definition of new entrant is made under regulation making powers contained in the 2003 Act, meaning the definition of ‘tenant’ flows through that Act to the new entrant provisions in SSI 2017/300. The 2003 Act defines tenant as (unless the context requires otherwise):

‘the holder of land under a tenancy constituted by a lease and includes the executor, assignee, legatee, disponee or legal representative (within the meaning of Part 1 of the Children (Scotland) Act 1995) or the trustee or interim trustee in the sequestration, under the Bankruptcy (Scotland) Act 2016, of a tenant’s estate’.

In determining whether a tenant under a lease constituting an MLDT is a new entrant or not, regard has to be had as to whether or not that person has previously been a tenant under different categories of agricultural tenancies (see regulation 3(3)). It would seem unfair that someone who acts as an executor for a deceased farmer would be considered to have been a tenant and could therefore be excluded from being a new entrant for the purposes of this section. While the context of the new entrant provisions may have required a different meaning of tenant to apply than that contained in the 2003 Act, to put the matter beyond doubt we decided to make clear that certain categories would not be considered as falling within the meaning of tenant when looking at their ‘tenant history’ for the purposes of determining whether regulation 3(3) applies to that person.

I trust that this information will be helpful to you and look forward to a useful discussion.

Yours sincerely,

FERGUS EWING
Annex A

Process for determining a new entrant for the purposes of section 5B of the 2003 Act (non-shared lease). For a shared lease follow this process for each of the tenants in common or joint tenants to determine whether or not they would be a new entrant, and then see whether the balance lies with new entrants/ non-new entrants to determine whether the lease for that tenancy can include a break clause.

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Tenant

Are they a natural person?

Yes

Does regulation 3(3) apply?

Yes

Tenant is not a new entrant

No

Tenant is a new entrant

No

Tenant is not a new entrant

Does regulation 3(3) apply?

Yes

Does more than one person have control of the tenant (within the meaning of regulation 5?)

Yes

Does regulation 3(3) apply to each of the persons who between them can be said to control the tenant (determined by the application of regulation 3(5)(c))?

Yes

Tenant is not a new entrant

No

Tenant is a new entrant

No

Tenant is not a new entrant

Does regulation 3(3) apply to the person with control of the tenant?

Yes

Tenant is not a new entrant

No

Tenant is a new entrant
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