December 2009

Review

Property @ction

Welcome to the third edition of the quarterly review prepared by Hammonds' Property @ction Team. In this issue we look at the following:

(i) Can the seller keep a deposit if the purchaser fails to complete?;
(ii) Sub-letting at less than passing rents;
(iii) Admissibility of pre-contract negotiations in interpreting an ambiguous contract;
(iv) Relocation, relocation...

We would also like to thank Stan Ravenhill, Director, Eddisons Chartered Surveyors for his article:

(v) Interrogating the witness: Removing a hiding place – the arbitrator's view.

We welcome all contributions to this review and if you would like to discuss this further please contact any of the editorial team.

Can the seller keep a deposit if the purchaser fails to complete?

In present times, the instances of transactions failing to complete is on the increase. Due to rapidly changing economic circumstances parties may suddenly find themselves in a very different financial position to when they entered into an agreement to purchase.

What happens when a deposit is paid by a party who enters into a contract to purchase land, but then fails to complete the transaction in accordance with its contractual obligations? Is the purchaser entitled to have the deposit back, especially if the seller goes on to sell the property at the same price or even at an increased price? A recent case[1] has made it clear that this will not be the case unless there are exceptional circumstances.

Section 49(2) Law of Property Act 1925 – The Court's Discretion

Section 49(2) Law of Property Act 1925 ("LPA 1925") provides the Court with a discretion to order the seller to return the deposit paid to it by the potential purchaser. Prior to the LPA 1925 there was a long established principle that if a deposit was paid on the sale of land and then there was failure to complete on the part of the purchaser, this resulted in the deposit being forfeited and the court had no power to grant any relief. Following the enactment of Section 49(2) the important question became under what circumstances will the Court exercise this discretion? Some have argued that there should be a liberal exercise of the discretion, as the retention of the deposit is akin to a penalty. However, the recent case of Midill has established guidance that this will not usually be the case.

Previous Case Law

The previous case law did not provide a clear picture. Some cases suggested that there should be a liberal approach and others provide for a much more restrictive interpretation of the

1. Midill Limited v Park Lane Estates [2008] EWCA Civ 1227

discretion. This made it difficult to predict the outcome of any litigation on the subject. There were some indications that where the seller did not suffer any loss, then the Court could exercise its discretion to order the return of a deposit to the purchaser. However, in a recent case[2] the Court held that its discretion should only be exercised in exceptional circumstances and based its decision on the need for certainty and the common knowledge that a deposit is likely to be forfeited.

***Midill v Park Lane Estates* – The Facts**

Midill entered into an agreement to buy all the shares of Park Lane Estates, whose sole asset was a property. The agreed purchase price was £4 million and a deposit of £400,000 was paid. When Midill failed to complete Park Lane issued a notice to complete. However, it was still unable to complete and the contract was rescinded. Park Lane then went on to sell the property to another unconnected party for an increased premium of £4.3 million. However, Park Lane retained the deposit and did not repay it to Midill.

Understandably, Midill sought to reclaim the £400,000, arguing that the Court should exercise its discretion and order that the defendant should not be allowed to retain the deposit. It based its arguments on the fact that Park Lane had not suffered any loss, as it had sold the property for an increased amount.

First Instance Decision

In the High Court, the Judge decided that this case was not an instance where his discretion should be exercised to order the repayment of the £400,000. He believed that too much uncertainty would be created if the basis of the exercise of the discretion was dependant upon the potential resale of the property.

Court of Appeal

In the Court of Appeal, Midill argued that the High Court Judge had taken an overly restrictive view of the Court's ability to exercise its discretion under s.49(2) and that the discretion should be exercised in any circumstances where it is the fairest course of action between the parties.

The Court of Appeal, however, agreed with the lower court and held that this was not a case where the discretion should be exercised. The Court stated that generally there must be some special or exceptional circumstances to justify overriding the party's ordinary contractual obligations. The fact that the property was later sold to another party at an increased price did not constitute such exceptional circumstances. To have held so, would have created too much uncertainty.

CONCLUSION

The decision in Midill has established some clearer guidance on the exercise of discretion by the Court under Section 49(2) LPA 1925. The Court will not exercise its discretion as a matter of course and rather exceptional circumstances will be required. It appears that the fact the seller suffers no loss as a consequence of the purchaser's breach of contract in failing to complete will not be sufficient exceptional circumstances.

2. Omar v El Wakil [(2001)] EWCA CIV1090

Sub-letting at less than passing rent

In these straightened times, many tenants are considering sub-lettings of whole or part in order to reduce overheads. However, most commercial leases provide that any sub-lease of the premises must be at no less than the rent payable under the tenancy. This can cause a problem for tenants of properties whose rents were fixed at a time when the property market was buoyant, and who are attempting to sub-let in today's market.

CONSEQUENCES OF GETTING IT WRONG

Some tenants may take the risk and sublet at less than passing rent in breach of the lease provisions, leaving themselves open to the following remedies available to the landlord:

- forfeiture of the lease – probably unlikely again due to the present market;
- a claim for damages, potentially including future damages such as loss of rent[1] and damage caused by the sub-tenant[2], from the tenant;[3]
- the seeking of an injunction against the tenant preventing the completion of the sub-lease;
- the seeking of an order from the Court that the sub-tenant is to surrender the sub-lease.

In addition, if the landlord can prove that the sub-tenant was aware that the premises were being sub-let without the necessary consent, the landlord may claim damages from the sub-tenant for wrongful interference with the headlease.

WAYS ROUND THE DIFFICULTY

- **The Side Letter**
  It used to be common practice for tenants whose leases were subject to a provision against sub-letting at less than the passing rent, to enter into a sub-lease at full passing rent and enter into a side-letter with the sub-tenant to reduce the actual rent payable.

  This practice was effectively ended by a 2002 Court of Appeal case[4] which held that the side letter and sub-lease were interdependent documents and had to be read together. When read together, the two documents clearly had the effect that the sub-lease was at less than the passing rent, and the tenant was found to have breached the terms of the lease. This is therefore no longer a viable option.

- **A Reverse Premium**
  Where a lease permits it, the tenant may be able to set up a reverse premium. In one recent case,[5] the sublease showed the passing rent under the headlease as payable, but the tenant placed a sum of money into an escrow account, which released periodic payments to the sub-tenant, equal to the difference between the passing rent and the rent agreed between the tenant and the sub-tenant. This was held to be part of a genuine transaction and not a breach of the covenants not to sublet at less than the paying rent.

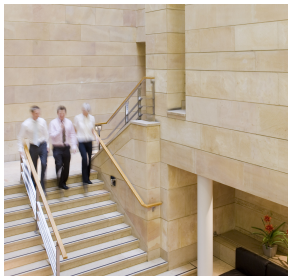
  The major drawback to this type of arrangement from the tenant's point of view is that the tenant would have to have access to the necessary capital which could be tied up for the duration of the sub-lease.

- **An Indemnity**
  The sub-tenant could be indemnified against paying the full passing rent by a party other than the tenant. This alternative has not yet been the subject of a judicial decision; however it has been getting judicial consideration[6] and it is currently understood that such an arrangement would not be a breach of a covenant not to sublet at less than the passing rent, even if the third party were associated with the tenant.

  This would appear to be an acceptable solution for many tenants, the only risk being that it has not yet have been judicially approved.

- **Waiver of the Provisions**
  A tenant can always approach the landlord and ask him to waive the provision of the lease which prohibits sub-letting as less than the passing rent. On 20 April 2005 the British Property Federation issue a declaration on sub-letting in which several major landlords - including British Land, Land Securities and the Crown Estate - agreed to waive the restrictions on sub-letting at less than the passing rent in their lease except in five exceptional circumstances.

1. Cohen v Popular Restaurants Limited [1917] 1KB480
2. Lepla v Rogers [1893] 1QB31A
3. The measure of damages has been held to be "such a sum as will, as far as money can, put the (landlord) in the same position as if the covenant had not been broken"; Williams v Earle [1868] LR3QB739
4. Allied Dunbar Assurance plc v Homebase Limited [2002] EWCA siv 666
5. NCR Ltd v. Riverland Portfolio No 1 Ltd [2004] EWHC 921 (Ch)
6. Crestfort Limited v Tesco Stores Limited [2005] EWHC 805 (CH)



Admissibility of pre-contract negotiations in interpreting an ambiguous contract

A recent case[1] has provided useful guidance on the admissibility of pre-contractual negotiations in determining ambiguous or disputed contractual terms and the current trends in rectification.

BACKGROUND

The claimant, Chartbrook, entered into an agreement with the defendant, Persimmon, for the development of Chartbrook's land. Under the agreement, Persimmon was to obtain planning permission for proposed works, carry out a development and then sell the properties. Chartbrook was then to grant leases to the buyers, from which Persimmon would receive the proceeds and pay Chartbrook a sum calculated in the contract in return.

The definition of the price contained a grammatical ambiguity. Chartbrook interpreted the definition literally, arguing that it was due to receive some £4.6 million. By contrast, Persimmon understood the price it was due to pay to Chartbrook to be around £900,000.

Chartbrook succeeded at trial and Persimmon's appeal to the Court of Appeal was dismissed. On appeal to the House of Lords, Persimmon's interpretation was unanimously allowed. It is the House of Lord's comments on pre-contract negotiations and rectification which are particularly worthy of note.

PRE-CONTRACT NEGOTIATIONS

During negotiations, Persimmon had set out its proposals in relation to the price to Chartbrook in a number of letters. These were accepted and formed the basis of the agreement.

Persimmon argued that these negotiations should be admissible in assisting the court to decide objectively what a reasonable person, with all the knowledge of the parties, would have understood the parties to have meant by the definition of the price to be paid to Chartbrook.

This was rejected by the House of Lords, who reaffirmed the rule ("the exclusionary rule") that pre-contractual negotiations are not admissible in the interpretation of terms, because allowing pre-contractual material could:

1. create uncertainty and cost, as parties would have to spend time and money wading through material;
2. encourage self-serving statements during negotiations; and
3. allow for a situation whereby a third party to a contract, who had not been privy to the negotiations, might find the contract meant something different to what he had thought.

RECTIFICATION

Persimmon also argued that, in the alternative, the contract should be rectified. The House of Lords decided that both parties were mistaken in thinking the written contract reflected their prior objective consensus and therefore allowed rectification.

This element of decision amounts to a significant clarification on the law of rectification for common mistake.

Previously, case law on rectification had set out two contrasting strands of thought: an equitable remedy that looked at the true (i.e. subjective) intentions of the parties, and a remedy designed to ensure contracts reflect the contractual (i.e. objective) intentions of the parties. The latter view has now been firmly endorsed.

The fact that the directors of Chartbrook subjectively thought the pre-contractual proposals meant something different to what the proposals meant (looked at objectively) was irrelevant. The crucial point was whether both parties were mistaken in thinking that the contract reflected their objective intention and consequently it was rectified.

1. Chartbrook Limited v Persimmon Homes Limited [2009]UKHL 38

Relocation, relocation…

THE BACKGROUND

The rationale behind Part II of the Landlord & Tenant Act 1954 is to protect the business interests of tenants. Unless a lease of commercial premises is specifically excluded from the legislation, then on its expiry – provided certain formalities are complied with – the tenant is entitled to a new lease on similar terms at a market rent.

A landlord is only entitled to oppose renewal of the lease if the tenant has been a "bad" tenant – not paid the rent, failed to comply with its obligations in the lease – or on two "no fault" grounds:-

- that the landlord intends to redevelop the premises; or
- that the landlord intends to occupy the premises for the purposes of a business to be carried on by it.

The landlord must prove a firm and settled intention to redevelop/occupy at or soon after the date of any hearing.

The Landlord & Tenant Act 1954 was substantially amended in 2004, including the provision of a new section (37A(2)) to cover a situation where the tenant has left the premises either after making and subsequently withdrawing an application for a new tenancy; or without making an application; and it is made to appear to the court that it did so by reason of misrepresentation or the concealment of material facts. We have just had the first decision of the Court of Appeal on that section.[1]

THE FACTS

Inclusive Technology ("Inclusive") occupied business premises under a lease which was due to expire in December 2006. In February of that year, Mr Williamson – the landlord – warned Inclusive that possession might be required at the end of the lease in order to carry out refurbishment works. This was subsequently confirmed by the tenant in a conversation with the landlord's agent. In June 2006, the landlord served a section 25 notice to expire at the end of January 2007, opposing renewal on the redevelopment ground. The covering letter referred to the previous exchanges and said that it was necessary to obtain vacant possession to carry out the intended works. By September 2006 the landlord had decided to delay the works but did not inform the tenant and instructed his agent to market the property.

In November 2006, the tenant signed a lease on new premises and relocated its business in December 2006. Once Inclusive discovered that in fact the landlord was not intending to refurbish, it commenced proceedings under section 37A(2) for damages for misrepresentation or the concealment of material facts.

THE DECISION

Carnwath LJ in the Court of Appeal said that the purpose of the 1954 Act was to encourage fair dealings between the parties. The landlord's right to determine the lease and so disrupt the tenant's business were based on his subjective intentions and could be open to abuse. He therefore held that the landlord's failure to inform the tenant that its intentions had changed amounted to misrepresentation and concealment, which led to the tenant giving up possession of the premises and the tenant was therefore entitled to compensation.

The Court of Appeal did however hold that the mere inclusion of the ground of opposition in a section 25 notice was not sufficient to amount to a representation.

THE LESSONS

The lessons which landlords should take from this case are:

- be very careful about what you tell the tenant about your intentions; and
- if your intentions change, notify the tenant as soon as possible.

1. Inclusive Technology v Williamson [2009] 39EG110

Interrogating the witness: Removing a hiding place – the arbitrator's view

Some arbitrations have full hearings, very similar to those which take place in front of a judge in court. Witnesses are questioned. The strength of the evidence is explored and its weaknesses exposed; the integrity of the witness soon becomes clear.

But many arbitrations are conducted on a documents only basis. Witnesses will make a statement (produce a report) and then write a further statement (a reply) addressing the points made in the other side's initial statement or report. The documents only procedure is frequently preferred on the grounds that it is quicker and cheaper than having a hearing – in my view a doubtful proposition. Documents only has its drawbacks, perhaps, the main one being that the reports and replies of a witness often avoid, slide over or only partially address areas which are difficult for him to deal with openly and honestly. In a hearing you can force a witness to address such a difficulty or weakness but you cannot normally do this if you are restricted to written reports and replies.

One way of dealing with this is for a party to apply to the arbitrator or for the arbitrator to call for a hearing – provided of course, that the directions have not precluded this. The objections to doing so are that a hearing at this stage will add to the expense and cause delay and, of course, avoiding expense and delay were the main (apparent) motives for choosing documents only in the first place.

There is a further way of putting the witness to the test. That is by requiring the witness to answer specific written questions arising out of his report and reply. This way of proceeding is referred to in the Arbitration Act 1996 (the Act) under Section 34(2)(e) but in my experience it is little used.

The relevant parts of Section 34 state:

"34(1) It shall be for the Tribunal to decide all procedural and evidential matters, subject to the right of the parties to agree any matter.

34(2) Procedural and evidential matters include –

34(2)(e) Whether any and if so what questions should be put to and answered by the respective parties and when and in what form this should be done;"

Section 34(2)(d) will apply to the arbitration unless it is agreed by the parties that it should not. However, its use could be disruptive unless it is properly controlled. Addressing its use at the preliminary meeting (to determine procedure) should achieve this and it has the additional benefit of alerting the parties to the possibility of being put on the spot.

To incorporate Section 34(2)(d) into the procedure adopted for the arbitration a suitable initial direction might include:

- Questions arising from the expert witness statements/submissions and replies are to be made by the parties by [date within 14 days of the date for replies].
- Responses to questions are to be made by [14 days later].
- Questions may be put by the arbitrator at any time.
- Responses to questions by the arbitrator are to be made within 14 days.

What if a witness refuses to answer the question? The arbitrator could at that stage issue a Peremptory Order under Section 41 of the Act. Such an Order would repeat the direction for the party to answer the question. Failure to comply could, for example, lead to the arbitrator being able to disregard part of the evidence being put forward by that witness.

Section 34 (2)(d) offers a cheap and effective way of shining the search light into the shadowy areas where witnesses might otherwise be inclined to skulk.

Stan Ravenhill

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Latin Quarter

Each quarter we shall be describing a Latin phrase commonly used in property law which we hope you find useful.

Ad Medium Filum
Ad Medium Filum is a common law presumption regarding the boundary of land next to a highway. The presumption only applies where the conveyancing history of the land and road is unknown. The presumption means that the owner of land adjoining a highway is presumed in law to own the subsoil of the highway up to the middle, even where the conveyance makes no reference to the highway.

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