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Property @ction Review

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Introduction

Welcome to the 11th Edition of the Quarterly Review from Squire Sanders' Property@ction Team. In this issue we will look at the following

(i) A harsh lesson for tenants

(ii) Negotiating the difficult relationships involved in dilapidations

(iii) The importance of being registered: *Chaudhary v Yavuz*

(iv) A new era in dilapidations claims?

(v) When is a condition (in a lease) not a condition?

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

A harsh lesson for tenants

The recent case of ***Avocet Industrial Estates LLP v. Merol Limited***[1] is a further reminder to tenants of the perils that lie in wait when exercising conditional break clauses.

The tenant held a lease of premises in Dudbridge, Stroud which it sought to break. The break clause was to be of no effect where, amongst other things, at the break date (a) any payment due on or before the break date had not been paid; and (b) the tenant had not paid its landlord a sum of six month's annual rent.

There were two key arguments by which the landlord suggested that the operation of the break was invalid. **Firstly**, the six months rent payment had only been made by cheque the day before the break date and so, it was argued, had not been paid by the break date itself in cleared funds. **Secondly**, rent had been paid late on a number of occasions throughout the lease term. This triggered a liability to pay default interest. The tenant's failure to pay this default interest (even without receiving a calculation of the amount due from the landlord) meant, the landlord argued, that a payment due under the lease remained outstanding as at the break date and consequently the break had not been validly exercised.

Payment by cheque

The common law rule is that a creditor must pay his debt by a tender of legal currency and a cheque is not legal currency. However, this common law rule does not apply where there is an express or implied agreement to the contrary, which can be inferred by conduct. This includes where there has been a practice of a party making periodical payments by cheque and where the cheques have been accepted.

[1] [2011] EWHC 3422 (Ch)

Here, the Judge was prepared to accept that there had been a course of dealing whereby the landlord would accept cheques. This was the case, notwithstanding correspondence from the landlord complaining of continual late payments. This implied agreement (by which cheques were accepted) was also not displaced as a result of the tenant voluntarily paying by BACS (rather than cheque) on a number of occasions.

Finally, the landlord argued that an implied agreement of this kind could never have been intended to relate to a sum due under a break clause where time for payment was expressed to be of the essence. This argument was rejected by the Judge, finding that the course of dealing related to every type of sum due under the lease.

Payment of default interest

Having found in favour of the tenant on the first issue, the Judge went on to consider whether the failure to pay default interest invalidated the break. Unfortunately for the tenant, it did; even though the interest amounted to only around £130.

The Judge found that the tenant was able to calculate the sum owed without any real difficulty and that it should have been paid.

He then went on to consider whether the landlord was estopped from claiming that any sum was due. He found that there had been no positive statement from the landlord to the effect that default interest was not payable or that it would only become payable if demanded. Further, this was not the type of case where the landlord had a duty to speak and tell the tenant that default interest was owed. While silence or inaction can, in some circumstances, constitute a representation for the purpose of estoppel, here, the landlord did not know what default interest was owed prior to the break date. It could not be said therefore that it had sought to take advantage of the tenant's mistake in not paying default interest.

Lessons

1. Where any payment is required to satisfy a break condition, payment should have cleared well in advance of the break date. A same day electronic payment (by CHAPS) will usually be the safest option. There are inherent dangers in relying on payments by cheque.

2. Careful consideration should always be given as to whether or not default interest is payable to satisfy a break condition, particularly if it is reserved as rent. If the calculation is not provided by the landlord and is not easily ascertainable, it is preferable to make payment of a sum in excess of what could be owed and worry about a refund of any overpayment later on.

3. While it did not work here, the Judge highlighted the possibility of an estoppel argument where a landlord remains silent while knowing that its tenant has not complied with break conditions. This may, possibly, assist tenants in circumstances where a landlord has knowingly remained silent in the knowledge that a break condition will fail.

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Negotiating the difficult relationships involved in dilapidations

The recent property downturn has caused a new and difficult problem for landlords, head lessees and sometimes sub-tenants who find themselves thrown together by the inability of a landlord to redevelop its property. This issue occurs when a landlord is forced to keep its property to maintain the short term income instead of redeveloping as initially planned, often causing a head lessee or its sub-tenants to be caught off guard and stuck with large dilapidation charges.

The situation arises when a long term lease is coming to the end and the assumption that the building will be torn down when the lease expires has meant that neither landlord nor tenant has been addressing defects, charging sufficient service charge and setting money aside to cover any dilapidations. In one example that occurred in 2009 in the City of London, a head lessee of a fully sublet 50,000 sq ft (4,645 sq m) building was left with a £3.6 million dilapidations liability when the freeholder who had planning permission decided to postpone redevelopment.

It is impossible to predict the market and the most recent recession which has halved property values in some regions has curtailed schemes by many landlords, some of whom have gone into administration. Timing is everything and where leases have circa 5 years still left to run landlords or head lessees need to consider measures to mitigate potential lease end liabilities including dilapidations.

Each landlord / head lessee will need to take different steps to minimise dilapidations but generally the following steps will help:

- Dilapidations Audit: The lease obligations are analysed and an assessment of likely dilapidations is prepared which incorporates the landlord or head lessee's fees where the lease confirms they are recoverable. Such an exercise does not have to be exhaustive but does need to pick up the main heads of any claim in order that money can be set aside or a strategy for mitigating any claim can be established.

- Service Charge Audit: Lease obligations are analysed together with both current and previous collection systems which should identify any shortfalls or indeed overpayments. New budgets, sinking funds and accruals for the balance of the lease term can then be created to allow for the maximum recovery of service charge during the remaining lease term.

- Planned Preventative Maintenance (PPM): Maintenance of the building fabric and mechanical and electrical services are often neglected when it is considered that premises will be redeveloped. When defects arise short term solutions on a reactive basis are more often than not implemented on the premise that there is no need to replace any components that will soon be stripped out. With a change in market conditions, however, the landlord will now look to put the building back into repair before the end of the lease term so that the property can be ready for marketing when the head lease comes to an end. Understanding what these works are and the likely cost is important for both sides as the landlord will look to recover most of this money from the Service Charge provision in the lease.

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- Alterations: Most leases have provision for tenants to undertake alterations within their demise providing permission is formalised by way of a Licence to Alter. Such a document is signed by both parties and usually contains a provision for the reinstatement of any alterations at the end of the lease term. It is, however, not uncommon for this process to be overlooked particularly where both parties know the plan is to redevelop the site. When this situation changes all alterations need to be formalised in order that both parties know what is to be expected of them at the end of the lease term. Without provision for reinstatement a landlord or head lessee could be left footing the bill for very costly reinstatement works.

- Agency & Landlord & Tenant Issues: Undertaking a review of the lease will determine much of the liability at lease end and consideration should be given to security of tenure; the timing and serving of notices and future property requirements. With landlords keen to maintain an income stream on properties and tenants keen to minimise costs many landlords and tenants are open to early discussions. Rents and interim rents are of key consideration and advance planning, consideration and preparation can ensure the best possible outcome for both parties and keep any disturbance to the business to a minimum.

In these changing times landlords and tenants need to review their position where leases have circa 5 years still left to run in order to mitigate potential lease end liabilities including dilapidation charges.

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The importance of being registered: *Chaudhary v Yavuz*

It is often the case that between owners of adjoining land, informal arrangements will evolve in relation to access. This can cause problems when one party decides to sell to a third party who is not necessarily privy to the agreements reached by their vendor, and the new owner can find itself at loggerheads with his established neighbour.

In order to provide a degree of certainty to purchasers of land, the Land Registration Act 2002 greatly limited the ability of owners to assert the benefit of informal arrangements over purchasers of neighbouring land by stipulating that, with few exceptions, an unregistered agreement will not bind a purchaser. This provides greater certainty for purchasers, but sometimes at a high cost to the existing neighbouring landowner, as the recent case of ***Chaudhary v Yavuz***[2] demonstrates.

The facts

Mr Chaudhary was the registered owner of No 37 Balaam Street, which consisted of two flats above a ground floor shop. His property was separated from the next door property, No 35, by an alleyway, which formed part of the title to No 35. No 35 had a similar layout to No 37 with the exception that, instead of access to the first floor flats being via an internal staircase, access was via an external staircase rising from the alley between the buildings.

The staircase that serviced No 35's flats was in a poor state, so Mr Chaudhary agreed with the registered owner of No 35, Mr Vijay, that Mr Chaudhary would pay for a new metal staircase to be installed up the side of No 35, with a walkway across the alley at first floor level to allow external access to No 37's flats. This was duly done and Mr Chaudhary subsequently removed the internal staircase to the flats at No 37 to increase the floor space in his ground floor shop. Mr Chaudhary prepared a deed of easement for Mr Vijay's signature, but the deed was never completed and the agreement was not protected by notice on the register of No 35.

In December 2006, Mr Vijay sold No 35 to Mr Yavuz, which Mr Yavuz inspected prior to purchase. Shortly after the purchase, Mr Yavuz began to dispute Mr Chaudhary's right of access to the first floor of No 37 via the external staircase and, after a number of incidents, Mr Yavuz arranged for contractors to cut the connection between the top of the staircase and the walkway to No. 37, and to remove the part of the balcony which was attached to No. 37, effectively severing access to No. 37's flats. Unsurprisingly, Mr Chaudhary brought a claim against Mr Yavuz for a declaration that he was entitled to a right of way over the staircase.

The decision

The judge at first instance decided in Mr Chaudhary's favour, on the grounds that Mr Chaudhary was in "actual occupation" of the staircase, which would mean that the agreement was an overriding interest and would be effective even though it was not registered, and/or that Mr Chaudhary had a constructive trust over the staircase which would make it unconscionable for Mr Yavuz to deny Mr Chaudhary's rights.

[2] [2011] EWCA Civ 1314

However, the Court of Appeal took a different view. It held that:

- The use of an easement will very rarely, if ever, count as "actual occupation" so as to give the person with the benefit of the easement an overriding interest. Certainly the normal use of a right of way does not count as "actual occupation".

- It is possible for an informal arrangement to give rise to a constructive trust on sale of the burdened land; however, in order for this to be the case it must be absolutely clear and unequivocal that it was the intention of the vendor and purchaser of the burdened land to protect the arrangement on transfer. The use of Standard Conditions of Sale which provide that the sale is subject to "incumbrances that are discoverable by inspection"[3] will not suffice to protect informal arrangements that are in place.

Conclusion

This case highlights the importance of ensuring that any rights over neighbouring land are registered on the title of that land before sale to a third party. Had Mr Chaudhary protected his interests with a legal easement at the time of the agreement with his neighbour, or even lodged a unilateral notice before the sale to Mr Yavuz, he would have been in a much stronger position to assert his right of way. The common law doctrine of notice is increasingly irrelevant - in this case, Mr Yavuz clearly knew or ought to have known about the right of way, but because it was not registered he was able to overcome that right.

Latin Quarter - Quantum Meruit

Quantum Meruit, literally "*the amount he deserves*", is a measure of damages payable to a claimant for work carried out, where the defendant refuses to carry out his side of the bargain.

The aim of quantum meruit is to compensate the claimant at the market rate for the work carried out, and/or to prevent the defendant from being unjustly enriched at the claimant's expense. Claims for sums on a quantum meruit basis usually arise where there is no valid contract between the parties that covers the work carried out by the claimant; for example, where the claimant has commenced work for the defendant whilst negotiations over the contract price are ongoing, or where the defendant asks the claimant to carry out additional work outside the scope of an existing contract. In order to be successful, the claimant must show that the defendant expressly or impliedly requested, or freely accepted, the claimant's services.

"*Quantum valebat*" ("as much as it is worth") is the equivalent concept for situations in which the claimant has supplied goods, rather than services.

[3] Condition 3.1.2(b), Standard Conditions of Sale, Fifth Edition

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A new era in dilapidations claims?

Following much anticipation, the Civil Procedure Rules (CPR) have now formally incorporated a specific pre-action protocol to deal with claims for dilapidations.

The rather snappily titled "*Pre-Action Protocol For Claims For Damages In Relation To The Physical State Of Commercial Property At The Termination Of A Tenancy*" will fortunately be commonly referred to rather more easily as "*The Dilapidations Protocol*".

We have had specific protocols governing the pre-action conduct of parties in other areas of litigation for more than a decade. This latest addition to the CPR is the result of extensive consultation between the Civil Justice Council and professional bodies, notably the Royal Institute of Chartered Surveyors and the Property Litigation Association.

The Dilapidations Protocol was formally adopted on 1 January 2012 and will, amongst other things, enable a tenant to apply for a dilapidations claim to be struck out if the landlord has not complied with the Protocol. It overtakes the former (non-binding but regularly followed) Property Litigation Association ("PLA") dilapidations protocol, although this had no formal status under the CPR.

History of the Protocol

Back in July 2000, the PLA produced a first draft of the Protocol. This sought to encourage the early resolution of dilapidations disputes without recourse to the courts and to rein-in excessive claims by landlords. The draft Protocol was endorsed by the Royal Institute of Chartered Surveyors and was then formally published in early 2002.

A second edition of the draft Protocol was published in September 2006. This made various tweaks, including moving the time for service of the landlord's diminution valuation from the beginning to the end of the pre-action process.

May 2008 saw the introduction of a third version of the draft Protocol. This removed the requirement for the landlord's claim to include a written endorsement of the landlord's loss. Instead, this version required the landlord's surveyor to provide details of the extent and cost of the required works.

The Adopted Version

The final CPR-adopted version of the Protocol has undergone a number of changes in order to ensure that it is compatible with the existing CPR Pre-Action Protocols. Although the adopted Protocol is much shorter than previous incarnations, the substance is largely unchanged.

The Protocol in a little more detail

Definitions

Some phraseology has been amended from the preceding drafts to ensure compatibility with definitions used elsewhere in the CPR. For example, references to *"serve"* have been amended to *"send"* in order to distinguish the giving of a demand from the service of court proceedings.

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Landlord's Endorsement

The landlord's endorsement has been amended so as to require the endorsing party to have considered the landlord's future intentions for the property at the end of the term of the lease. The finalised wording of the endorsement also reflects the fact that if the schedule is endorsed by the landlord's surveyor, the surveyor is relying on the position as confirmed to him by the landlord.

Tenant's Endorsement

The Protocol requires the tenant's surveyor to provide an endorsement on the tenant's response to the Quantified Demand. This removes the obligation on the tenant to consider items which they believe the landlord or its surveyor may have missed in the Quantified Demand. However, the response should not attempt to strike out works required by the landlord which the tenant or its surveyor believe are necessary.

Alternative Dispute Resolution (ADR)

As with the other pre-action protocols, one of the key objectives is to ensure that disputes are only referred to the courts as a last resort. The Protocol requires the parties to consider whether any form of ADR would be appropriate and makes it clear that neither party should commence proceedings whilst negotiations are on-going. If there was any doubt about the courts' position on this, the Protocol states (at para 8.1) that "*Parties are warned that the court will take into account the extent of the parties' compliance with this protocol when making orders about who should pay costs*".

Sanctions for Non-Compliance

As will be clear from the comments on ADR, failure to comply with the requirements of the Protocol may result in costs sanctions against the defaulting party. Care should be taken to ensure compliance with the Protocol in order to avoid such sanctions, although it is unlikely that minor or technical breaches will result in penalty.

Conclusion

The formal introduction of the Protocol gives clarity to the process that the courts expect parties to dilapidations disputes to follow before issuing a claim. It is hoped that this will assist in reducing litigation and will therefore save time and cost for all involved. Whilst it was of course the case that parties were already required to comply with the general Practice Direction on Pre-Action Conduct, and many practitioners have been following the informal protocol for some time, the formalisation of the process should help to ensure that both parties to a dilapidations dispute understand their obligations.

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When is a condition (in a lease) not a condition?

Service Charges

Multi-let commercial and residential premises are usually let on the basis that each tenant pays rent for and keeps in repair/decorated its own unit and the landlord keeps the structure, exterior and common parts in repair, cleaned, lit, heated and decorated etc.; the cost of which – the service charge - is apportioned between the tenants, with the apportionment often based on the relative size of each unit.

The service charge often comprises other items too. In a shopping centre it may include security, advertising, Christmas decorations…In residential accommodation it may include security/concierge and communal facilities, for example, a leisure centre.

It is often said that a lease is a – special – form of contract. The obligation to pay the service charge – usually quarterly on account estimated amounts, with a balancing credit or payment once the accounts for the year have been drawn up – is a contractual obligation on the part of the tenant. Often the landlord's obligation to provide the services is expressed to be conditional upon the tenant paying the service charge.

It should follow, as a matter of simple contract law, that if the tenant does not pay, the landlord is consequently not obliged to provide the services.

Clearly though, in a multi – let building, the services are provided for the benefit of all and it would be impractical and unfair for the landlord to turn off the lights in the common parts due to one tenant's failure to pay his service charge contribution.

In *Yorkbrook Investments Ltd v Batten*[4] the Court of Appeal held that

> "the question whether liability in respect of one covenant in a lease is contingent or not upon the performance of another is to be decided, not upon technical words, nor upon the relative position of the covenants in the case, but upon the intention of the parties to be gathered from the whole instrument."

In that case where the landlord's obligations to provide the services were expressed to be "subject to the lessee paying the Maintenance Contribution…" the Court nevertheless determined that the obligation to provide the services was not conditional upon payment of the service charge and that the landlord had that obligation whether or not the tenant paid the contribution.

If the tenant fails to pay the service charge, then the landlord has remedies available for that breach of covenant, such as court proceedings, the service of a statutory demand or forfeiture.

The lease in *Yorkbrook* was quite an old one – the flats were built prior to the Second World War -

[4] [1985] 2 EGLR 100

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and the cost of the hot water and heating for the whole block of flats was paid by the landlord and then recovered from each tenant through the service charge. Notwithstanding the fact that the tenant, Mr Batten, had not paid the service charge, he was entitled to recover damages in respect of the breach of covenant by the landlord, Yorkbrook, to provide a good, sufficient and constant supply of hot water and an adequate supply of heating in the hot water radiators.

Quiet Enjoyment

Another example of a scenario in which it would seem that the performance of a covenant by the landlord is conditional upon performance of other covenants by the tenant, is the covenant for quiet enjoyment:-

> "If the Tenant pays the rent reserved by and complies with all its other obligations under this lease, the Landlord will allow the Tenant to occupy the Premises without any interruption or disturbance from the Landlord or from anyone lawfully claiming through or under him."

There is authority going back to 1885, (*Edge –v- Boileau* (1885) 16 QBD 117) - so, even older than the flats in *Yorkbrook* – that the words of the standard quiet enjoyment covenant are introductory and do not create a condition precedent. In other words, the failure by the tenant to pay the rent due or comply with its obligations in a lease, will not release the landlord from its quiet enjoyment covenant.

Conclusion

The two examples given are by far the most common examples of drafting in leases which would appear at first sight to render the performance by the landlord of its obligation conditional upon performance by the tenant. The courts have held that the obligations are independent not co-dependent and it is thought that, except in very unusual circumstances this would follow through into other similar provisions.

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