

Uncertainty in dilapidations

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Introduction

In the field of dilapidations, definite or categoric advice seems to be difficult to come by. A dilapidations claim is essentially a legal claim, and it's perhaps typical of anything that leads to litigation, or is capable of leading to litigation, that definite advice is very difficult to get. The outcome is always uncertain. Counsel sometimes give advice in terms of probability of success - rarely rising above 60:40, in my experience. Nonetheless, dilapidations cases seem to be particularly prone. Perhaps it's the surveyors' fault - particularly the valuers - for not having given accurate, targeted or analytical enough evidence in the past. The Courts seem to regard the valuer witnesses who come before them with a particularly jaundiced eye, and the attitude of Counsel probably reflects that.

Fact and degree

As a first example of the uncertainty principle, I'm struck by what Dowding and Reynolds¹ call "the test of fact and degree". This test is particularly relevant to whether something can properly be called a repair, or whether it's something that goes beyond repair. They draw attention to the possibility that renewal of subsidiary parts of a building may well be repair, whereas renewal of the whole probably isn't. There seems to be virtually every shade of possibility in between, so it's said to be an application of the "test of fact and degree" to determine where on that scale a particular item of building work sits.

I hope the reader won't think I'm over-cynical if I suggest that this is really the "How on earth do I know?" test. In other words, the learned authors are telling us that you can't tell how the Courts will treat any given building work, and whether they'll call it repair or something going beyond repair. This might not be quite so serious if it were restricted just to this area of dilapidations, but it isn't. It seems to me that it suffuses virtually all dilapidations problems, such that it's often extremely difficult to get advice on how the Courts will view particular issues. It's for surveyors - valuers and building surveyors - to help. They can do so by developing objective methods of dealing with dilapidations claims.

In this article, I've selected three areas where I've personally experienced diametrically opposite advice being given, sometimes from the same learned Chambers, and sometimes in the same month.

¹ Dowding and Reynolds: Dilapidations - the modern law and practice (fourth edition) (Sweet and Maxwell)

Valuation where the landlord doesn't do the work

I've had the almost surreal experience of being advised by different, but equally eminent, Counsel in the same Chambers in two successive weeks, in cases where valuation considerations arose in a dilapidations context:

1. that the best rule where the landlord doesn't carry out the work in the schedule of dilapidations is: "no work, no claim"; and
2. that, in most dilapidations cases, including those where the landlord doesn't do the work, the claim is roughly equal to the cost of works.

So there it is. The advice is: (a) that the landlord has no claim; and (b) that he has a claim equal to 100% of the cost of works. It won't surprise practitioners in the field to know that, in the first case, I was acting for the landlord and, in the second, for the tenant!

Actually, I don't think either of these attractively simple views is correct. I think the truth lies somewhere in between. The "somewhere in between" is valuation analysis. What the valuer has to do is to determine the diminution in value consequent on the dilapidations.

The starting point ought to be this thought. We are speaking of a given property: valued on exactly the same date; in the same location; subject to the same marketing; with the same configuration and arrangement - in fact in every conceivable respect the same property, except for one difference and one difference alone, namely the former tenant's compliance with covenants. (If you don't believe me, read *Mason*²). At first blush, such a property might be considered to be worth the same, adjusted only for roughly the cost of works to comply with those covenants. That could fairly be called the normal, or default, effect. It seems to me that it's incumbent on the valuer who says (as is perfectly possible) that the effect on value is less than the cost of works, to justify that in detail by reference to the schedule of dilapidations itself.

Whether one is a lawyer or a surveyor, one's instincts turn to valuing by reference to comparable evidence. However, there are many cases in which that can take one's eye off the ball. After all, it is only the diminution in value one has to find, not the absolute values, even though no doubt the absolute values have to be reasonably sensible and likely. The common valuation error - one I suspect a building surveyor or even a lay person would not make - is what might be called "premature approximation". If one starts with a rough figure for the value of the property, the diminution effect gets lost.

² *Mason v. TotalFinaElf UK Ltd* [2003] EWHC 1604: *The diminution is to be assessed as at the lease expiry date. It involves two valuations of the landlord's interest. The first is on the assumption that the premises were then in the state that they would have been in if the tenant had performed his covenants. The second is of the premises in their actual state and condition at that date. the purpose of the exercise is to isolate the effect on value of the tenant's failure to do the relevant works, from which it follows that the only variable between the two valuations is the works. All other factors are constants.*

So seen in these terms, it's a matter of analysing the schedule of dilapidations to determine:

- which breaches of covenant have the normal or default effect on value suggested above;
- which have no effect on value;
- which (as can occasionally happen) have a positive effect on value; and
- which have a negative effect on value less than the cost of carrying out the work.

Obviously, it's necessary to ignore margin of error for the time being; even a small item may have an effect on value in these terms.

I go somewhat further. It seems to me that it's necessary for the valuer to explain why an item of work that appears to be needed should not have an effect on the value of the property roughly equal to its cost. There are plenty of reasons available; supersession, probability, deferment, beneficial breaches and others - things that in the space available to me in this article I can't really cover.

So the key to resolving the "no claim"/"100% claim" conundrum is analysis of the effect of the schedule of dilapidations on value, on an item-by-item basis. Often this can be done by the building surveyor. Much of the analysis is no more common sense.

Res inter alios acta

We're not allowed to use Latin any more, but I don't know what the correct English translation for this is. It's something like "thing between others done" or, in rather more natural language, "things done by people who are not party to the dispute".

Respectable legal opinion has begun to doubt whether *Haviland v Long*³ is quite in line with current opinion on damages. However, in that case, it was said that the terms of a subsequent deal could not be taken into account to reduce the damages due from one person to another. In a dilapidations context, this is normally a reference to the letting or sale of the building that takes place some time after the date of valuation (which, incidentally, is the date on which the tenancy expires).

I've been advised by eminent Counsel on different occasions: (a) that *Res* cannot be taken into account at all, and (b) that anything happening within a reasonable time after the date of valuation can be taken into account.

Once again, in valuation terms, I think the truth lies somewhere between these two diametrically opposed positions.

A valuation on a particular day implies sale and purchase. By definition, the vendor and the purchaser cannot be aware of things that have yet to happen. So, if a letting takes place

³ [1952] 2 QB 80

three months later and the prospect of that letting was unknown at the date of valuation, then the vendor and purchaser could not have taken account of it. Indeed, the valuer may very well say it was quite unpredictable. On the other hand, the valuer must be able to say so, otherwise he's coming dangerously close to saying he understands the market better than those who actually participate in it, and that can't be.

So if a transaction takes place sometime after the date of valuation, the valuer must examine that transaction, consider it, and explain why (if so) he thinks it is not a good guide to the value of the property on the relevant date. Once again, therefore, I suggest that it's not really a matter of law at all; it's a matter of valuer's judgment - intelligently interpreting all the facts that he has before him, including those that take effect after the date of valuation. On the other hand, he must be sceptical about anything that takes place after the date of valuation. He must ensure that he's not using the benefit of hindsight falsely in arriving at his figure.

The effect of schedules of condition

It's common for lettings to take place subject to schedules of condition. The tenant may take (for example) a full repairing lease, but the full repairing obligation is qualified by requiring him to hand the building back at the end of the lease in no worse condition than is evidenced by the schedule of condition. Schedules of condition can be used in a variety of ways, but that would be typical.

Strangely - considering how much trouble and heartache it causes - tenants of industrial buildings, holding on a long-term, full repairing basis, sometimes sublet subject to a schedule of condition. I would say the first rule for those thinking of making such arrangements is "Don't!", but let that pass.

Suppose we have some metal gutters and downpipes on the building in question. The schedule of condition shows these to have been in poor-ish order when the lease was granted - let's say they were rather rusty and poorly decorated, but still functional. At the end of the lease, we find that these gutters and downpipes are now seriously rusted, quite free of paint and that some of them are barely functional, if at all.

Now considering that, after a tenancy has come to an end, the landlord's claim is always in damages - that's to say just for money - how should this deterioration be valued? It's rather obvious that you can't turn a very rusty downpipe into a rather rusty downpipe; in other words, you can't only partially reverse the deterioration. Learned Counsel in the same Chambers have suggested the following:

- a) The only real way of complying with the covenant to repair subject to the schedule of condition is to carry out the whole of the required repair or, if that isn't possible (and it probably isn't in our downpipe and gutter case), renew the object in disrepair. Thus the claim against the (sub)tenant is for the cost of full renewal of the gutters and downpipes.
- b) The intermediate landlord cannot enforce the covenant against the subtenant at all. He has the obligation to carry out the repair in full, whereas the subtenant's obligation

to carry it out is qualified and reduced. Thus the obligation to carry out the reduced standard of repair is superseded by the intermediate landlord's obligation to carry it out in full.

Again, I suggest (very respectfully) that the truth lies between these extremes.

In the case of *The Baltic Surveyor*⁴, we're reminded that a claim in dilapidations is a claim in money: financial restitution, not physical restitution. It's here that the clue lies; the answer is what I would call the "on your watch" test. In other words, the enquiry is to establish the extent to which the item in question deteriorated during the lifetime of the tenancy in question. If it's half, then the covenantor would pay half the cost of renewal; if 5%, then 5% of the renewal. Of course, this doesn't close the issue; there's plenty of scope for argument about what the "watch" is. Should it be treated simply as the number of years out of the total life of the building element? Alternatively, should it take into account that deterioration in building elements often accelerates towards the end of their life, particularly if they are not well maintained? Obviously, the enquiry should be a proper and sensible one, but inevitably lying well between the extremes of: (a) full claim; and (b) full supersession.

Conclusion - tentatively

The theme I detect in the three areas of uncertainty explored above (and there are more) is that the Courts (and hence Counsel) have yet to grapple fully with the problem of valuation in dilapidations, despite the great age of the principles involved, going back to the Landlord and Tenant Act 1927 and beyond. In my view, it is for the valuer to assist Counsel and the Courts to develop the idea of analysing the effects, so that the place of valuation in dilapidations cases may be enhanced and improved. It is perhaps unfortunate (but it's our own fault) that Counsel is very often inclined to see valuation in terms opposed to the valuer he sees in Chambers. I'm afraid this is because we have a bad reputation for simply putting forward or defending our clients' cases, rather than developing objective criteria by which such matters can be judged.

⁴ *Voaden v Champion (The "Baltic Surveyor" and "Timbuktu")* [2002] EWCA Civ 89