
Dilapidation Claims: the relevance of post-termination events

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Introduction

1. A lease of office premises ends on 23 June 2008. The tenant moves out, leaving considerable dilapidations behind it. The landlord, ably advised by Beckett & Kay and Charles Russell LLP, prepares to carry out the requisite remedial works, only to find, in quick sequence, that:

- (a) there is a subtenant in occupation of the whole premises, who contends that its occupation is lawful, and that it has every intention of seeking a new tenancy of the premises;
- (b) (while steps are being taken to investigate the sub-tenancy) the market for office premises crashes in September 2008 following the Lehman Bros affair;
- (c) the subtenant folds and moves out in October 2008;
- (d) the empty and insecure premises are immediately taken over by the bearded and sandal-wearing group “Offices for Homes for the People”, who remain in possession until removed following a court order, leaving behind them a trail of destruction;
- (e) there is by that time no earthly prospect of letting the premises for the foreseeable future, whether or not the remedial works are done;
- (f) the local planning authority announces that, in view of the dearth of hotel accommodation in its area, favourable consideration will be given to applications to convert redundant offices into hotels.

2. What should the landlord do? What should it have done? What are the rules that govern the calculation of the landlord’s loss in such circumstances? Peter Beckett and Emma Humphreys of course know the answers - but they are busy people, and not able to spare the time to bale you out in the similar circumstances your own client may face. So what should you advise?

A: THE RULES

3. Dilapidations are breaches of repairing provisions in contracts, and the rules, such as they are, largely follow normal contractual principles: the damage must have been caused by the breach; it must be foreseeable; the loss recoverable must reflect that which has actually been suffered; and it must not be time-barred.

4. Repairing covenants (but not other condition covenants such as covenants to reinstate) are of course subject to a special additional rule, imposed by section 18(1) of the Landlord and Tenant Act 1927:

“Damages for a breach of a covenant or agreement to keep or put premises in repair during the currency of a lease, or to leave or put premises in repair at the termination of a lease, whether such covenant or agreement is expressed or implied, and whether general or specific, shall in no case exceed the amount (if any) by which the value of the reversion (whether immediate or not) in the premises is diminished owing to the breach of such covenant or agreement as aforesaid¹;

and in particular no damage shall be recovered for a breach of any such covenant or agreement to leave or put premises in repair at the termination of a lease, if it is shown that the premises, in whatever state of repair they might be, would at or shortly after the termination of the tenancy have been or be pulled down, or such structural alterations made therein as would render valueless the repairs covered by the covenant or agreement”².

5. Aside from this, there are really no rules that apply. This has not however prevented practitioners interpreting the many authorities that populate the dilapidations landscape as if they give rise to rules of general application. The purpose of this paper is to examine the most prevalent of these non-rules.

B: THE NON-RULES

(1) All events occurring after the valuation date are inadmissible

6. This non-rule should be considered together with its cell-mate: all events occurring after the termination date are admissible.

7. Take the paradigm case of the office block that is delivered up in disrepair at the end of the lease. The relevant valuation date here will obviously be the contractual term date, because that is the latest date for compliance with the

¹ Usually referred to as the ‘first limb’.

² The ‘second limb’.

covenants³. *If* the breaches have an effect on value, then the landlord will have suffered a loss, and the task facing it will be to establish the quantum of that loss.

8. The loss will not, even at common law, necessarily equate to the cost of carrying out the requisite remedial works, because that is not the *measure* of the loss, but rather the cost the landlord incurs in attempting to *make up for* its loss. That cost may be rejected as representative of the loss for a number of reasons. Here are the most obvious two:

- (a) the cost may be too extravagant; and
- (b) the works may be unreasonably delayed, by which time construction costs may have risen.

9. In any event, the loss is subject to the ceiling imposed by s.18(1), which *appears* to require an objective assessment of the diminution in the value of the reversion attributable to the breaches⁴.

10. So, the starting point in any dilapidations claim, in the context both of the loss at common law and of s.18, is to consider what loss the landlord has actually suffered at the valuation date. At this point, the analysis departs from the intuitive. First, the parties' views as to value are not restricted to what they personally know about the premises and the market, but will include all that could have been ascertained at that time⁵.

11. Secondly, and by contrast, although the parties are assumed to be omniscient, they are not prescient. They can only take into account what is discoverable about the market and the premises at the valuation date. A valuation on 9/10 cannot therefore be influenced by the events of 9/11. The tenant cannot say that the disrepair has caused the landlord no loss because any repairs would have been rendered valueless by the occurrence of unconnected events after the valuation date such as (a) a tidal wave striking the premises; or (b) squatters

³ If the tenant remains in possession under a periodic tenancy or 1954 Act continuation tenancy, the valuation date will be pushed forward until (simplifying a little) the date possession is recovered.

⁴ Although if the test applicable to the first limb is indeed objective, that would be at odds with the traditional subjective interpretation of the second limb, which nevertheless uses similarly objective language.

⁵ This will of course be limited to knowledge in the public domain. There is an interesting contrast with the position concerning the extent of the breach. Here, the tenant is liable to the full extent, whether or not the breach was discoverable at the time. For example, if the premises suffer from dry rot which is only discoverable once the fabric is taken apart during the course of the remedial works, then the tenant is liable, even if it could not reasonably have discovered the breach at the time.

moving in and vandalising them; or (c) a change in planning policy (such as the more favourable outlook on hotel conversions referred to above).

12. But this does not necessarily mean that each and every post-valuation-date event is not evidentially useful. Although the event itself has not occurred by the valuation date, the facts which give rise to it may well have done, and if so the event may well be relevant evidence of value at the valuation date.

13. This point tends to arise in relation to two types of post-valuation-date event in dilapidations disputes. The first is a transaction occurring after the valuation date, which one party or the other will attempt to adduce in evidence. The second is action taken by the landlord after the valuation date, like the execution of the remedial works, or the grant of a new lease with a rent-free period in return for the execution of the remedial works by the new tenant. Technically speaking, neither event can be taken into account as part of the background valuation matrix, since by definition neither will yet have occurred. But each may well be evidentially useful. I deal with the first situation here, and the second as part of my treatment of Non-rule (2) below.

14. First, as far as post-valuation-date transactions are concerned, the point is most neatly encapsulated in the judgment of Knox J in Re ESC Publishing Ltd [1990] BCC 335. The judge was concerned with a submission that an offer for shares that had been made after the valuation date was inadmissible in proceedings to determine the share value. He rejected the submission in the following words:

“[Counsel] argued that an offer was a change in the market and not a piece of evidence which was a guide to what the value at the valuation date was. It seems to me that this is so only if one assumes that value resides solely in existing transactions and offers. That is not a necessary or accurate assumption. ... Value is in effect what a purchaser will pay. Evidence of an offer one day after the date of valuation seems to me potentially to be evidence of the existence of a bidder on the date for valuation who was just plucking up his courage to bid what he did in fact bid the next day. I say ‘potentially’ because an offer is only an offer; all the more so an offer subject to contract. I am not concerned with those considerations for which a valuer can and should make such discounts as appear to him to be appropriate. If it was shown that the offer was not genuine no doubt the offer would fall to be wholly ignored. But on the question that it should be regarded as totally inadmissible because it is a post-valuation event, I prefer what may perhaps be a realist rather than a purist view and do not consider that the valuer should be required to ignore it altogether.”⁶

⁶ There are many landlord and tenant authorities to similar effect - see for example the judgment of Arden LJ in Latimer v Carney [2006] 3 EGLR 13.

15. So, if the tenant in the example set out at the beginning of this paper contends that the landlord should not recover more than a certain amount, because the market declined dramatically shortly after the valuation date, with the result that the premises were worth much less, in or out of repair, it may succeed. This could only be on the basis that the seeds had already been sown, so that the decline is merely the full-blown manifestation of a disease whose symptoms were already evident in the market. In such circumstances, then the decline may have a role to play in the valuation.

16. If, conversely, the evidence is that the decline was unforeseeable, then the valuation should not take the decline into account. This result may be said to benefit the landlord unfairly - but had the tenant complied with its covenants and yielded the premises up in repair on the valuation date, then the landlord could have benefited from their value then, and might have been able to re-let sooner rather than later, at a rent which reflected the pre-crash market.

(2) If you do the work, you can always recover the cost

17. This, too, should be considered together with the converse non-rule: If you don't do the work, you can never recover the cost.

18. If the landlord "does the repairs", to use the conventional argot, then this is unfailingly put in evidence as the landlord's actual loss (together with such additional losses as the rent foregone during the time taken to do the works). Strictly speaking, however, the actions taken by the landlord are after the event (ie the valuation date), and are inadmissible in themselves.

19. So much for the theory. In practice, the landlord's action in doing the work is, or may be, evidentially useful in at least three ways:

- (a) it helps to show that the landlord's reaction to the condition of its premises is real, rather than a tactical stunt to make money out of its tenant which it was never going to spend on remedial works;
- (b) it provides some information as to the actual cost of the remedial works (as opposed to quantity surveyors' estimates); and
- (c) it will have some relevance in cases where there is a dispute between valuers as to whether the premises have only development value.

20. Each of these pointers may of course be challenged, on the basis that the execution of the works by the landlord is not determinative either of the cost of the works, or of the diminution in the value of the reversion. Indeed, the landlord's subjective perception of the need for the works does not resolve the questions whether the works were necessary and cost-effective. But the sheer fact that they have been or are being done is normally a good start.

21. Lastly, and perhaps most powerfully of all, the execution of the works has great tactical significance, because it will bring pressure on the tenant. Cases where landlords actually do the work but nevertheless fail to recover the cost are very rare⁷.

22. None of this is intended to suggest that the landlord cannot recover its loss where the works are not done. There may be all sorts of reasons why the landlord does not wish to do the works, even if, on balance, they do affect value. For example:

- (a) it may not have the resources to do so;
- (b) it may not wish to divert its energies into project management;
- (c) it may prefer to crystallise its loss by selling or letting the premises to a third party at a discount;
- (d) it may be uncertain about the market, or otherwise wish to hedge its bets.

23. The difficulty for the landlord will lie in convincing the tenant (and, in default, the court) that its failure to do the works is not attributable to the fact that the works are simply not worth the money. Cases such as Ultraworth Ltd v General Accident Fire & Life Assurance Corporation plc [2000] 2 EGLR 115 show that this is not something that is always successful.

24. In practice, therefore, the position is rather more nuanced than the advocates of either non-rule would accept. A good summary of the position was given by Neuberger J in Craven (Builders) Ltd v Secretary of State for Health [2000] 1 EGLR 128:

“In a case where the landlord has carried out the works, or clearly intends to carry out the works, then the cost of the works is, or at least can be, prima facie evidence of the diminution in value. However, in a case where the landlord has not carried out the works, and there is no evidence that he intends to carry them out, then the cost of the works is of no assistance.”

(3) Loss of rent can always be recovered

25. And the converse non-rule is, of course, that loss of rent can never be recovered where the premises cannot be re-let.

⁷ Mather v Barclays Bank plc [1987] 2 EGLR 254 is one such example - but there the landlord failed because it was not able to distinguish the genuine remedial works it had done from its general refurbishment works.

26. Here, the proper course of inquiry is whether the tenant's breaches of covenant have caused the loss. In other words, would the hypothetical purchaser of the reversion bid less because it would factor in the loss of the beneficial use of the premises while the works are done (or the loss of rent, if it proposes to lease them)?

27. This is a question of evidence rather than principle. In most cases, if the works need to be done, then it probably goes without saying (but should nevertheless be said) that the holding costs and other losses attributable to the time estimated for the remedial works programme should be added in. There are, however, two situations where this component of the loss may not be recoverable.

28. First, where the market is slack, the tenant is likely to contend that the works can be accommodated within the period during which the premises would not let in any event. Although such contentions are unlikely to find favour with the court, the landlord should not neglect the need to establish the requisite evidence in its favour⁸.

29. Secondly, if the facts are such that the hypothetical purchaser is likely to carry out other works at the same time as the repairs, which are likely to take the same time or longer, then it cannot be said that the breach has 'caused' any loss of rent⁹.

(4) Damages cannot be recovered where there is a subtenant in possession

30. Suppose that the tenant leaves a subtenant in occupation under a tenancy to which Part II of the Landlord and Tenant Act 1954 applies, and the subtenant has, by the valuation date, applied for a new tenancy of the premises. Suppose too that the repairing obligations in the tenancy mirror those in the headlease. Can it be said that landlord has suffered no loss, because the hypothetical purchaser of the premises will be purchasing a reversion subject to a tenancy with a full repairing covenant?

31. The answer, as always, is - it depends. There is, again, no rule that applies. Instead, the correct approach must be to analyse the evidence, to see what the position was known to be at the valuation date. If:

- (a) the subtenant was certain to renew; and
- (b) the renewal was of the whole of the premises; and

⁸ See the words of caution to this effect by the Deputy Judge in Scottish Mutual Assurance Society Ltd v British Telecommunications plc (unreported decision given on 18 March 1994).

⁹ As the court held in Firle Investments Ltd v Datapoint International Ltd [2000] EWHC 105 (TCC).

- (c) the covenants were identical to those in the former headlease; and
- (d) the standing of the subtenant is no less than that of the tenant;

then the landlord will probably be unable to prove that it has suffered any loss, because its recourse against the subtenant will be comparable to its recourse against the tenant¹⁰. If any of those factors is absent, or uncertain, then the converse will follow. The outgoing tenant cannot argue down the diminution by contending that it had an interest in reoccupying the property which would have appealed to the hypothetical purchaser, in the absence of evidence of that interest at the valuation date¹¹.

32. The sting in the tail for the landlord is if what at the valuation date appeared to be a certainty (eg the subtenant renewing its tenancy) turns out not to be the case after the event. In such a case, the subtenant's failure to renew (for example as a result of an apparently unforeseeable insolvency) will be a supervening event that breaks the chain of causation. The landlord would therefore be unable to recover any damages.

And here, finally, are two more non-rules worth mentioning, although they do not concern post-termination events:

(5) Unlawful alterations need not be reinstated if executed more than 6 years ago

33. Suppose that in 2003, a tenant installed a mezzanine floor without consent, in breach of a covenant against alterations in its lease. Upon expiry in 2010, can a landlord require reinstatement?

34. Once again, there are no rules (beyond the application of the statutory limitation period): everything will turn upon the terms of the lease and the facts of the case.

35. As to the limitation period, a claim in respect of a breach that occurred more than 6 years ago will be barred (s.5 Limitation Act 1980), unless either (a) the lease was made under seal, in which case the limitation period is 12 years (s.8 LA80); or (b) the breach was not known about by the landlord at the time, and proceedings were instituted within three years of the date of knowledge, subject to a 15 year maximum (s.14A).

¹⁰ See the decisions in Family Management v Gray [1980] 1 EGLR 46; Crown Estate Cmssrs v Town Investments Ltd [1992] 1 EGLR 61; Lyndendown v Vitamol Ltd [2007] 3 EGLR 11.

¹¹ See the recent decision of the Court of Appeal in Van Dal Footwear Ltd v Ryman Ltd [2009] EWCA Civ 1478.

36. Suppose then that the lease is not under seal and the landlord knew of the breach of the time. Does it follow then that the tenant escapes liability?

37. No – not necessarily. As with all these problems, the answer will lie in the lease, which may contain specific drafting reimposing liability (eg a yield-up covenant requiring the tenant to reinstate all alterations at the end of the lease.)

(6) Tenant’s fixtures should always/need never be removed

38. Neither proposition, of course, is correct. Again, the wording of the lease is the beginning and end of the voyage of enquiry. Here, leases vary widely. Commonly encountered provisions include (usually in conjunction with express obligations to repair and sometimes to reinstate) the following types of yield up covenant:

- (a) one *requiring* the tenant to take out all its fixtures and make good;
- (b) one *entitling* the tenant to take out all its fixtures and make good;
- (c) one requiring the tenant to *leave* all its fixtures;
- (d) one requiring the tenant simply to yield up the premises in good repair, *where the premises are defined in a way that excludes fixtures*;
- (e) a yield up covenant that is silent on the question of fixtures.

39. The default position is that a tenant is entitled, but not obliged, to remove ‘tenant’s fixtures’. This expression has been the subject of much judicial commentary over the years. In essence, a tenant’s fixture is an item installed in the premises in such a way as to become part of the structure, but not to such a degree that it cannot then be taken out without damaging either the premises or its own utility.

40. The default position is often overridden by the lease, as the examples above show. Example (a) ousts the default position by obliging the tenant to remove its fixtures, and the costs of removal will form part of the landlord’s damages claim, uncapped by s.18 (because the failure to remove fixtures is not a breach of repairing covenant). Examples (b) and (e) reflect the default position. Example (c) (seldom if ever encountered) ousts the default position by obliging the tenant to leave its fixtures behind.

41. Example (d) contains a trap for the unwary. In this example, the yield-up covenant is silent on the question of fixtures, leading those unfamiliar with this type of drafting to conclude that the default position applies. However, if the premises are defined in a way that *excludes* tenant’s fixtures (and the repairing covenant does likewise), then it is arguable that these must be removed. Were it

otherwise, the tenant could yield up the premises with the fixtures intact but in disrepair, which is hardly a conclusion that a court would welcome.

42. And lastly: do not assume that merely because something is a tenant's fixture, it cannot also be an alteration (lawful or unlawful). The two categories often overlap, with results that need to be thought through carefully.

Conclusion

43. The analysis above should serve as a warning to those who seek to elevate decisions on the facts of particular cases into principles of universal application. In every case where post-valuation-events are concerned, the proper approach will be to consider the extent to which the events in question throw light upon the situation as it existed at the review date, either because the events have a causal link to that situation, or because they provide some form of confirmatory evidence.

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