OPTIONS AND OVERAGE

- securing a share in the enhanced value -

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by

Brie Stevens-Hoare QC
Hardwicke

Brie Stevens-Hoare QC is a very client focused specialist in property and property related work. Her main focus is on real property and the more commercial aspects of property work including disputes around property developments and commercial property. In addition, Brie has considerable experience of property related professional negligence and contentious probate matters involving property.

Brie has been recommended in the Legal 500 as a leading property practitioner every year since 2002 and has also been ranked within Chambers UK for the same length of time. In 2005 Brie was appointed as a Deputy Adjudicator to HM Land Registry. In 2010 she was reappointed. That appointment draws on her extensive experience of property litigation and has allowed her to further enhance her knowledge and skills.

She has been described in the directories as "An all round modern QC. Super-bright, incredibly hardworking and a great court room advocate " and “...wonderful to use and doesn’t stand on ceremony”.

Mediation is another major string to Brie’s bow. She has the benefit of a great deal of experience of mediation from both angles: representing clients in mediations and as a mediator. She is increasingly in demand in both capacities. Brie has also contributed to several editions of Foskett “The Law and Practice of Compromise” and Cousins “The Law of Mortgages”.

HARDWICKE

Hardwicke Building
Lincoln’s Inn
London WC2A 3SB

Tel: 020 7691 0036
Fax: 020 7691 1234
Email: brie@hardwicke.co.uk

Introduction

The Scope of this Talk

1. Options and overage agreements along with conditional contracts and pre-emption agreements are all contractual tools at our disposal to give clients flexibility when dealing with (or contemplating dealing with) land. Clients may wish for flexibility for any number of reasons but all arise out of the desire to take advantage of or protect against future contingencies. Often the future contingencies are matters that can have a significant impact on the value of the land and/or its attractiveness to the purchaser or potential purchaser. This talk will not address conditional agreements at all. Some reference will be made to pre-emption rights giving their relationship to options.

2. As lawyers, we can come at these types of agreement from different angles:

   Transactional
   - drafting, tailoring documents to meet, so far as possible, client's commercial 'wish list' – trying to second guess potential eventualities but maintain legal certainty;
   - advising the parties when one wishes to exercise the rights they believe they have
   - conveyancing for subsequent purchasers;
   - advising lenders

   Litigation
   - Construing the documents
   - Seeking or resisting enforcement against the original parties
   - Seeking or resisting enforcement against successors in title
   - Suing the transactional lawyers (the wonders of hindsight).

3. Unfortunately these types of agreements generate a disproportionate amount of disputes which translate into a surprisingly high number of decided cases. There are a number of reasons these types of contractual tools give rise to disputes. The reasons for that are probably that they:

are bespoke for the particular property and deal
are generally in existing for a prolonged period
they are often in part relational contracts
deal with the future and involve the risk of unforeseen events
some of the contractual obligations will not run with the land and yet need to be protected against third parties
commercial flexibility and contractual certainty are conflicting desires

4. Perhaps inevitably, those who were content with a deal when the additional gain/profit was theoretical often seek to avoid or extend the deal when there is an actual profit or loss at stake.

5. The terms used in this paper are not necessarily terms of art but they are in common usage in the property industry. For the purposes of this paper the terms are used in the ways described in the next four sections. It should be noted that hybrids of these types of arrangement are also common. Also classification is useful only as a starting point. Of course every case turns on its facts and the specific form of words used in the contract in question. In particular, much can turn on the definitions of terms used within contracts and the effectiveness of attempts to bind successors in title / third parties.

Defining the terms

An Option

6. By way of contrast, an option is a unilateral contract in which one of the parties has the power to abandon it or force its performance.

7. Option is used in this paper to refer to contractual arrangements relating to interests in land that:-

stand between an offer and an unconditional contract;

include a right vested in one party to exercise or relinquished a transaction on fixed terms within a defined period;

imposes an obligation on the other party to proceed with such a transaction contingent on the unilateral act(s) of the first party;

confer an equitable right over the grantor's land as well as a contractual right.

8. Options in that sense:-

Can relate to a purchase ("call options");

Can relate to a right to sell to a particular person ("put options");

Can related to the determination or renewal of a lease ("break clauses and renewal provisions");

May be stand alone contracts or terms within a conveyance; and

May be granted by a will.

9. In this paper we are focusing on "call options" and "put options".

A Pre-Emption Agreement

10. Pre-emption agreements are often referred to (not wholly correctly) as 'rights of first refusal'. This paper is not concerned with leaseholders statutory rights of first refusal, it is focused purely on those created by private contract.

11. In essence they involve a grantor (the owner of an interest in land) agreeing that he will not dispose of his property without first offering it to the grantee. In other words give the non-owning party an entitlement to be notified and/or receive an

offer before the owner/grantor is free to deal with third parties. The owner is not under any obligation to transact at all but his right to do so is fettered to the extent of the right. It follows they involve a triggering eventusually the formation of a desire by the owner to the transaction which rights in the other party's inchoate rights crystallising into a specific entitlement.

An Overage/Clawback Agreement

12. Overage is a payment, made by a purchaser to a seller, sometime after completion of a conveyance of land, which is paid in addition to the purchase price and where the obligation to pay is triggered by a later event. Such arrangements are sometimes called clawback rather than overage, for the purpose of this paper overage will be used.

13. There are many reasons for seeking overage for instance:

A developer may wish for a lower capital cost before development

A seller (particularly if a public body) can avoid being 'embarrassed' by the buyers' quick profit or uplift following the grant of planning permission etc

An adjustment on an allowance given in the purchase price for an unknown quantity (costs of removing contamination, development value pending planning permission etc)

14. Common types of overage are:

Planning overage

Onward sale claw back (possibly post planning)

Development/Sale overage

15. Usually overage provisions are included in a sale of property however the primary agreements could be a conditional contract with overage provisions or some other sort of hybrid of the agreements under discussion.

Perpetuity

A refresher

16. The starting point at common law is (in broad terms) that if a document purports to create rights which will take effect on some future date, those rights will be void unless those rights cannot take effect outside the perpetuity period (the length of a life or lives in being, plus 21 years).

17. The rule only applies to documents which create an interest in land. Merely personal, non-transmissible agreements are not subject to the rule (and in any event by very definition could only be exercised within the option holder's own lifetime!).

18. The rule was originally developed in the context of family settlements to curtail control by one generation of the use of property by future generations. However, later rule was extended to other types of property rights e.g. future easements, options and some pre-emption rights.

19. Essentially, any grant of an interest in property which *may potentially* vest after the perpetuity period is void from the outset and thus grants no equitable interest in the land (although will of course still be enforceable as a matter of contract between the original parties).

20. By the Perpetuities and Accumulations Act 1964, some leeway was granted. For example, a future interest arising after that Act is only rendered void if it must vest only after the perpetuity period. Up until that point, a 'wait and see' approach can be adopted – the agreement is not void from the outset.

21. Further, with respect to almost all options and indeed rights of pre-emption, a fixed (21 year) perpetuity period applied (see section 9(2)) – however, if an option does fail for perpetuity (i.e. attempt to exercise after the 21 year period), the option is likely to lose its status as an enforceable contract (as well as its status as an interest in land) – section 10 of that Act.

22. More recently, the Perpetuities and Accumulations Act 2009 came into force. This disapplies the perpetuity rule with respect to most land transactions, but only

where entered into on or after April 6 2010 (see sections 1 and 2 for a list of instruments where the rule still applies – largely dealings with trust property – options and rights of pre-emption fall outside these categories).

23. Because the 1964 and 2009 Acts only apply prospectively, you must check carefully the date of a transaction to see what law applies

The common law rule for transactions entered into before 16 July 1964

1964 Act for transactions entered between 16 July 1964 and 5 April 2010 inclusive

2009 Actfor transactions entered on or after 6 April 2010

How does it work?

24. A recent example of the impact of the rule was **Taylor v Couch** [2012] EWHC 1213 (Ch). The factual background was:

Buyer granted option to purchase adjoining land at time he purchased main site in 1984.

No express perpetuity period expressed in agreement.

Option expressed to be exercisable if no planning consent obtained for five years or if seller offered the property for sale.

Option registered as class C IV Land Charge.

Seller sold land in 1989.

Buyer sought to exercise option in 2009.

25. New owner claimed the option was now void for perpetuity as it had been granted more than 21 years previously (under 'wait and see' provisions); buyer argued that option was conditional and only became available for exercise when the land was offered for sale (in 1989) and thus 21 year period had not expired.

26. The decision of HHJ Hodge (sitting in Manchester DR) was that:

The agreement contained the grant of two rights:

- an option available after 5 years
- a right of pre-emption available only if seller proposed a sale (i.e. control over exercise of the option was vested in the landowner).

Both transactions were to be treated as options for the purpose of the legislation

s9(2) of the 1964 Act properly construed treated pre-emption rights as a sub-species of option:

The proviso in s.9(2) excluded certain specified rights of pre-emption from the scope of the subsection which meant that Parliament must have assumed that rights of pre-emption were, in general, within its scope.

The 21 years for perpetuity were to be measured from the date of the document.

The buyer's rights had thus been lost.

27. The decision in **Taylor v Couch** is to be contrasted with the decision in **Cosmichome Ltd v Southampton CC** [2013] EWHC 1378 (Ch), which specifically doubts Taylor's interpretation of section 9(2). The factual background was :

Council sold a site to the BBC for a nominal price on condition that property was only used as a broadcasting centre. In the event of any change of use, overage of 50 per cent of the increased value was to be paid. The restriction on use was protected by a restrictive covenant.

Further, a pre-emption agreement entitled Council to repurchase if property became surplus to BBC requirements.

Agreement was dated 1989.

2004 sale and leaseback did not trigger the right of pre-emption.

28. The Buyer subsequently applied for a declaration (a) that the restrictive covenant did not bind the land, and (b) that the right of pre-emption was void for perpetuity as it was (by then) more than 21 years since it had been granted. Blackburn J. held that the covenant should be discharged (as to which, see further below). On the argument that the right of pre-emption was void he held that:

The pre-emption rights remained valid

he qualifying period for the purpose of perpetuity should run from the date the right arises rather than the original grant.

There had been no proposal for a change of use, so the period had not begun to run. **Taylor** was considered and its reasoning rejected:

Blackburn J stated:

> *"In the light of the decision in* **Pritchard v Briggs** [1980] Ch. 338, CA *I am of the view, indeed in the light of the reasoning that underlies that decision I doubt that it is open to me to come to a different view, that Parliament proceeded on a wrong assumption (namely that a right of pre-emption did indeed give rise to an immediate interest in land) and that it would not therefore be right to regard the legislation as amending the law by treating rights of pre-emption exceptionally as if they give rise to an immediate interest in land. Looking at the issue more generally, I can see no reason why, where the right in question sounds at the time of its creation only in contract and may never mature into a right which confers on the grantee an interest in land, Parliament should have wanted to single it out and treat it as if, from the moment of its creation, the right had this added proprietary effect."*

29. The position is accordingly now unclear, however the reasoning in **Cosmichome** (following the Court of Appeal decision in **Briggs**) is, for now, to be preferred.

30. The answer to these conflicting decisions may lie partly in semantics. In **Taylor**, whilst HHJ Hodge describes part of the agreement as a right of pre-emption (because the ability to trigger the option by the developer was fettered by whether or not the landowner decided to sell), it was in his view nonetheless an option as it was still ultimately to be triggered by the developer. Blackburn J expressly disagreed with this analysis – the question was one of when a proprietary right arises (causing time to run), not what it is called.

31. Finally, to complicate matters further, it should be noted that in relation to registered land, section 115 Land Registration Act 2002 provides:

> *(1) A right of pre-emption in relation to registered land has effect from the time of creation as an interest capable of binding successors in title (subject to the rules about the effect of dispositions on priority).*

(2) This section has effect in relation to rights of pre-emption created on or after the day on which this section comes into force.

32. The section came into force on 13 October 2003. Accordingly from that date onwards, in relation to registered land at least, upon any grant of a right of pre-emption, the right would take effect immediately as an interest in land for the purposes of registration. It would therefore require registration or protection as an overriding interest if it is to bind successors in title. It would seem that for the purposes of an agreement affecting registered land which was entered into between the commencement of the LRA 2002 and the 2009 Act the Court would have to consider whether, for perpetuity purposes, time would run from the date of the agreement because for the purposes of the LRA 2002 there was an interest in land from that moment.

Options

More Detail

33. An option to purchase land gives the holder of the option the right, upon compliance with the terms of the option, to require the landowner to transfer the land to him. Options can be created between two contracting parties as a stand-alone agreement, in leases, in franchises or other commercial agreements or by will.

34. Options do not impose any duty on the option holder to purchase the land. They impose a duty on the landowner to sell at the option holder's election and a corresponding fetter on the landowner's right to deal with his land in the meantime. They are a unique form of contract which has two stages if exercised: grant and exercise. The first stage is a unilateral or "if" contract and the second, which arises on exercise, shifts the contract into being an operative bi-lateral contract for the transfer of an interest in land.

35. Options are governed by usual contractual principles, as they relate to an interest in land, including additional constraints and requirements applicable to such contracts. However, it is helpful to bear in mind a number of points:

Creation

Consideration or a deed is needed for standalone options (but not those in leases etc)

The grant of options but not their exercise must comply with s2 LP(MP)A 1989[1]

A variation of an option must also comply with s2[2]

Trustees (who are not the beneficiaries) granting an option must be mindful of their duty obtain the best price for trust property

Mortgagee's powers of sale include a power to grant an option

Effect, Duration & Registration

On the unilateral exercise the contract for transfer/disposal exists so the grant must contain all the terms required to see the transaction through to completion

An option may be for a fixed time, until an event and/or the grantor may reserve the right to revoke it by notice giving the developer a chance to exercise[3]

In the absence of an express limitation on the duration of an option the Courts are willing to infer a limit from the context at the time of grant[4]

The impact of perpetuities (see above)

An option in respect of unregistered land is an estate contract and must be registered as a Land Charge to be protected

Assignable

As a property right the benefit of options are generally assignable subject to the terms of the option itself

The benefit of options generally pass by will and intestacy

Exercise

Time for exercise is a key provision that needs very careful drafting in light of authority

[1] Spiro v Glencrown Properties Ltd [1991] Ch 537

[2] MP Kemp Ltd v Bullen Developments Ltd [2014] EWHC 2009

[3] Re Downes and Lobb's Contract [1937] 4 All ER 324

[4] Habermann v Koehler (1996) 73 P&CR 515

Options are regarded as a special entitlement which must be exercised in strict compliance with its own terms ie form and method of notice, timing, payment etc…

There is no need to re-register an option after exercise, since although there are two stages it is one contract

Using Options

Options are of particular use for "overage" where:-

The disposal is only going to happen if the development is happening

The vendor is content to wait to receive any of his pay-off

The developer does not need the land to raise finance etc

The vendor retaining ownership is not an inhibitor to the trigger event (for instance where the pay-off is triggered by the grant of planning permission not the development)

The developer is not required to invest too much prior to the trigger event

The price is already agreed or a means of determination such as OMV determined by an appointment expert

Section 2 of the LP(MP)A 1989 is going to be complied with

It is anticipated the arrangement will be protected at HMLR (by a notice or restriction)

36. The application of the usual contractual principles was highlighted in **Hallman Holding Ltd v Webster & anr** [2016] UKPC 3 (Anguilla). This concerned an option granted in Anguilla, where this is no equivalent of s2 of the LP(MP)A 1989. The express terms of the option did not address the title the vendor was required to give. Neither party hand pleaded any facts that could have formed the factual matrix at the time the option was created/granted for the purpose of construing the option as would be necessary. As a matter of general principle a contract to transfer land or an interest in land, would if nothing more were said, be construed as imposing an obligation to transfer good marketable title free from encumbrances and accordingly no implied term to that effect was require; **Mungalsingh v Juman** [2015] UKPC 38 (Trindad & Tobago). An option would be construed in just the same way without the need for an implied term to be established.

37. Options are a familiar and well tested form of property deal. They can be used to share the anticipated future profit of land. From a legal perspective they are a fairly robust solution. Both parties have an interest in the land and the position of both parties is able to be properly protected against further transactions. The limitations for options in the development context come from practical and financial factors. The recent case of **MP Kemp Ltd v Bullen Development Ltd** [2014] EWHC 2009 is a good demonstration of how even with careful thought this familiar and well tested form of property deal can create disputes. In that instance the option included a dispute resolution clause providing for determination by a surveyor. MP Kemp Ltd were unhappy with the way the surveyor construed the contract and found they were unable to appeal. In order to appeal they had to demonstrate the surveyor's decision was manifestly erroneous.

38. Very often the stage at which the landowner is to realise their share, the activity and investment that needs to have happened by that stage and funding arrangements required to facilitate it will rule out an option. It follows although options are generally a relatively clear and secure way of addressing the sharing of enhanced profits and/or added commercial value, for substantial developments, for developers who need capital and landowners wishing to maximize their share of the profits they are generally not a viable tool.

Drafting Points

39. Points to consider when drafting an option include:-

The trigger event

Exercise

- Form
- Mode
- Timing

Purchase price, formula and/or method for determining

All material terms for transaction included

Assignability

Dispute resolution

Protection

40. The fact that the creation of an option creates an equitable interest in land it is necessary for an option holder to consider how to protect that interest against third parties who may acquire an interest subsequently.

41. Whether the land affected is registered or unregistered registration of the option/interest it creates is essential to protect against purchasers, mortgages and others.

42. It should also be noted grantor's may well have an interest in an option being protected against third parties. A grantor of an option that does not inhibit their ability to transfer their interest, will not necessarily be released from their contractual obligations under the option by that transfer. In those circumstances the grantor has an interest in his successors and those deriving an interest from them being bound. Since an option holder would not owe the grantor any duty to registers the option it is common in some spheres to see the validity of options expressly subject to registration within a limited period of time. Grantor's can also protect themselves by a chain of covenants imposing obligations to secure covenants to comply with the option as part of any subsequent dealing.

The effect of non-registration between contracting parties

43. Unless the terms of the option are such that registration is a pre-requisite to validity it is not relevant to the relationship been the contracting parties. That situation aside as between the original contracting parties the remedies of specific performance or damages for breach of contract are unaffected by a failure to register.

Unregistered land & successors in title to grantor

44. An option to purchase is an estate contract for the purpose of the Land Charges Act 1972 [s2(4)(iv)]. Such interests are therefore registerable as Land Charges (Class C(iv)). Such an option can, and should generally, also be protected by a caution against first registration under the Land Registration Act 2002. The option holder will then be notified and have the opportunity to intervene prior to registration of any purchasers interest.

45. Since an option is registerable under the 1972 Act an unregistered option will be void against a purchase for money or money's worth of a legal estate in the relevant land. Money or monies worth does not involve an appropriate or significant consideration and a sale at a substantial undervalue or for a nominal amount is sufficient.

46. Good faith on the part of the purchaser is not required and accordingly bad faith does not assist the option holder[5]. Nor would actual notice. It follows a transfer of a legal estate at low value undertaken specifically to defeat an unregistered option will achieve its end so far as the ability to secure the property is concerned. Of course contractual rights against the original grantor may subsist depending on the proper construction of the option.

47. However a transaction dealing with a legal estate subject to an unregistered option may be ineffective as against the option holder if the transaction is a "sham" in the true sense of being a "pretence". The fact a transaction is a device is not enough. However a transaction which involves the parties doing one thing and saying another[6], so that they pretend to deal with the legal estate in one way whilst in fact dealing with it in another way, may be possible for the unregistered option to continue to be fully enforceable. Circumstances may also raise in which an option holder is protected by virtue of a constructive trust or estoppel.[7]

48. The failure to register does not however render an option unenforceable against a subsequent equitable interest. The option would then take its place on the basis of the usual priority between equitable interest by reference to the date of creation.

Registered land – prior to the LRA 2002

49. Under the LRA 1925 an option could be protected by a notice under s49(1)(c), a restriction under s58 or a caution against dealing under s54. In the absence of such registration, unless the option operated as an overriding interest, it would not be enforceable against a purchaser of a legal estate for valuable consideration.

[5] See s17(1) Land Charges Act 1972 and Midland Bank Trust Co Ltd v Green [1981] AC 513

[6] Belverdere Court Management Ltd v Frogmore Ltd [1997] QB 786

[7] Taylors Fashions Ltd v Liverpool Victoria Trustees Co Ltd [1982] QB 133 and Lyus v Prowsa Developments Ltd

[1982] 1WLR 1044 – but see also Hollington Bros ltd v Rhodes [1951] 2 TLR 691

50. It follows the consideration would have to be more than nominable but as with unregistered land good faith was not required. Similarly the fact the purchase had actual notice would not assist. A wise intending purchaser aware of the option would obtain a priority search to prevent the option holder protecting his position at the last minute.

51. The position between competing equitable interests would again be unaffected by the absence of registration.

52. As indicated above an option holder who failed to register might be protected as an overriding interest. Protection most often arises by reason of the option holder's occupation. For instance options granted to lessees contained in unregistered leases would be likely to benefit from such protection by reason of the actual occupation or receipt of rents. Occupation of part of the parcel of land involved would be sufficient.[8]

53. The transitional provisions under the 2002 Act preserve the protection afforded to pre October 2003 interests by the registration arrangements in place at that point in time. However since the benefit of unilateral notices can be transferred there are advantages for a move from a caution against dealings to a unilateral notice.

54. However pre-2002 options protected only as overriding interests are vulnerable in the event of post October 2003 transactions since the scope of overriding interests has narrowed.

Registered Land – Under the LRA 2002

55. Option can be protected by either an agreed or a unilateral notice. A unilateral notice which does not involve the need to support the claim with evidence is properly the easier choice. However the agreed notice results in a notice that is not subject to challenge and cancellation on the basis of invalidity.

56. Restrictions cannot be used where a notice could be it follows ordinarily a restriction would not be appropriate to protect an option. However there could be circumstances where the terms of an option include a right more properly protected by a restriction (a right not to have a transaction registered without your

[8] Ferrishurst v Wallcite Ltd [1999] 2 WLR 667

consent) or a specific right to a restriction. In those circumstances it is possible both forms of protection could be deployed.

57. A failure to protect will result in an option being ineffective against a registerable disposition, unless it is an overriding interest under Schedule 3 of the LRA 2002. The interests of those in actual occupation (not receipt of rents) will be protected in respect of the land occupied provided the exceptions in Schedule 3 para 2 do not arise.

58. Further it should be noted that if an interest is protected by a notice under the 2002 Act and the notice is then cancelled the same interest cannot be protected as an overriding interest.[9] It follows it is important once a protective entry is on the register to maintain the presence on the register and not rely on protections by other means.

Pre-emption Agreements

More Detail

59. Rights of pre-emption are tricky beasts. As between the grantor of a right of pre-emption and the grantee, the trickiness is limited in scope (and a subject for a different workshop). As between the grantee and a third party who acquires or wishes to acquire the land in question, they are very tricky indeed. The Land Registration Act 2002 has ameliorated the position so far as protection is concerned (see above under Perpetuities and below) but it only governs rights of pre-emption granted after 13 October 2003 in respect of registered land.

Drafting Points

60. Points to consider when drafting a pre-emption right include:-

Trigger

What is triggered - offer or invitation to treat

How right communicated

How right exercised/accepted

The terms of any offer or how they are to be fixed

[9] LRA 2002 s29(3)

Mechanism for finalising and progressing transaction

Grantor's rights to transaction with third parties

- Limits on
- Expiry or release of limits

Protection

61. As discussed above, where rights of pre-emption arise in respect of unregistered land or they predate the LRA 2002 it appears the reasoning in **Briggs** and **Cosmichome** applies. So, in order to determine if and when any particular right of pre-emption has become an interest in property capable of binding third parties, one must consider what is the triggering event and what the effect of the event is.

Protecting Unregistered Land – The trigger event

62. What event triggers the right of pre-emption is a question of construction of the agreement containing the right. In substance, the question is when the grantor's obligation ceases to be a negative one and becomes a positive one to offer the property to the grantee.

63. By way of example, in **Tiffany Investments Ltd v Bircham & Co. Nominees (No. 2) Ltd** [2004] 1 EGLR 31, there was a right of pre-emption in a lease requiring the lease to be offered to the lessor if the lessee wished to dispose of it. The right of pre-emption was in the following terms:

> "5. If at any time during the term hereby created the Lessee shall wish to dispose of the term hereby created in the demised premises he shall first offer the same in writing to the lessors stating the price at which he is prepared to sell the same and the encumbrances (if any) subject to which the said term shall be assigned. If the lessors shall not within twenty-one days of the receipt of such notice accept the offer therein contained the Lessee may within six months thereafter (subject to getting the lessors' consent thereto as hereinbefore provided) assign the said term to an approved assignee at a price equivalent to or greater than that at which it was offered to the lessors but shall not assign the same for any lesser sum than that at which it was last offered to the lessors without again offering the same in writing to the

lessors at such lower figure. Any such renewed offer shall specify the encumbrances (if any) subject to which the said term shall be assigned. If any such renewed offer shall not be accepted within a period of fourteen days thereof the Lessee shall be free to assign the said term to an assignee (subject to getting the lessors' consent thereto as hereinbefore provided) subject however to the obligation as aforesaid to offer the same to the lessors again in the terms of this clause if such assignment shall be proposed for any lesser sum than that at which it was last offered to the lessors."

64. It was held by the Court of Appeal that the lessees became in breach of the clause conferring the right of pre-emption immediately before they entered into an agreement to dispose of the lease to a third party without first offering it to the lessors. "The consequence of that breach was the creation in the lessors of an equitable interest in the lease comparable to that to which they would have been entitled if the provisions of [the pre-emption right clause] had resulted in a binding agreement for the sale of the lease … by the [lessees] to the lessors", per Sir Andrew Morritt V-C.

65. What exactly triggers the right is a question of construction, and possibly of implication. Questions that have arisen include whether a "desire to sell" would include a sale by way of surrender instead of by way of assignment, and whether the right of pre-emption is triggered by disposition by testamentary or inter-vivos gift.

The consequences of the trigger

66. The effect of the triggering event – in particular whether an interest in land arises – will depend on the terms of the right of pre-emption. In **Specialty Shops v Yorkshire and Metropolitan Estates Ltd** [2003] 2 P&CR 31 Park J distinguished between different types of pre-emption. In a type 1 case, the breach of the right of pre-emption, i.e. by sale to a third party, would give rise to an equitable interest in the property crystallising on the making of the contract with the third party. See *per* Templeman LJ in *Pritchard v Briggs* at 418-419.

67. Consequently, if the right of pre-emption had been protected by registration (see below), it would take priority over the rights arising under the contract with the third party. three types of clauses[10]:

(1) Upon the triggering event, e.g. the grantor desiring to sell, the grantor is obliged to offer the property for sale to the grantee and keep the offer open for a specified period; during that period the grantee would have an equitable interest in the land equivalent to that of an option holder.[11]

(2) Upon the triggering event the grantor is obliged to offer the property for sale to the grantee but is not obliged to keep the offer open for a specified period; the grantee would not obtain an interest in the property until the offer is accepted and a binding contract[12] arises.

(3) Upon the triggering event, the grantor is not obliged to offer to sell the land to the grantee, but rather he is obliged to notify the grantee of the situation, leaving it for the grantor to make his own offer to purchase the land if he chooses; if the grantee does choose to make an offer, only a very unusually worded agreement would provide that the grantor was bound to accept it; no equitable interest in the property would arise until a binding sale agreement arose on the grantor accepting the grantee's offer.

68. The position is the same in a type 2 case, even though the grantor could withdraw his offer before acceptance. See *Tiffany Investments Ltd v Bircham & Co. Nominees (No. 2) Ltd* at paras. 36-39.[13]

69. The position is less clear in a type 3 case. In **Specialty Shops v Yorkshire and Metropolitan Estates Ltd** Park J thought, albeit obiter, that only a claim in damages against the grantor could arise on breach. The authors of Barnsley's Land Options (5th ed.) nonetheless are of the opinion that as a matter of logic the position should be the same in a type 3 case.

[10] At paras. 26 to 29

[11] The right granted in *Pritchard v Briggs* is an example.

[12] Bearing in mind the need to comply with s. 2 of the Law of Property (Miscellaneous Provisions) Act 1989

[13] Note the apparently inconsistent dicta of Beldam LJ in *Homsy v Murphy* (1997) 73 P&CR 26 at 38-9 though.

70. Even though the right of pre-emption may have given rise to an interest in land by the time of the contract of sale to a third party, the third party may take free of it if not protected by registration. So it is advisable to register the right of pre-emption as a Class C(iv) land charge under the Land Charges Act 1972. This will not provide sure fire protection. For example, a mortgage granted to a third party is unlikely to trigger the right of pre-emption; if the mortgagee sells pursuant to its power of sale, a purchaser from the mortgagee would take free of the right of pre-emption. It would, though, provide protection in the event of a sale by the grantor to a third party in breach of the right.

71. A further step often taken to protect third party interests in unregistered land is not available to the grantee of a right of pre-emption. The grantee will be unable to register a caution against first registration – only a person entitled to an interest affecting a qualifying estate can to that.[14] For the reasons explained above, the grantee of a right of pre-emption does not qualify as that until the right has been triggered (if at all).

Rights granted before commencement of the LRA 2002

72. In respect of registered land and rights of pre-emption granted before the 2002 Act came into force, the position is even more difficult. The two usual forms of protection of the third party rights under the 1925 Act – a caution against dealing and notice would not properly be available in respect of a right of pre-emption which has not yet crystallised into a property right. A caution could only be made in favour of a person interested in any land (s. 54 of the Land Registration Act 1925) and a notice only in respect of a burden affecting a registered estate (s. 32(1) of the 1925 Act). So the grantor is likely to be able to have any cautions or notices to protect rights of pre-emption vacated.[15]

73. If the grantee was in actual occupation of the land when the right crystallised, though, the right would have the status of an overriding interest under s. 70(1)(g) of the 1925 Act and now under Sch. 3, para. 2 to the 2002 Act.

[14] S. 15(1)(b) of the Land Registration Act 2002

[15] As was ordered in *Specialty Shops v Yorkshire and Metropolitan Estates Ltd*

74. A better course may be to persuade/require the grantor to agree to the entry of a restriction preventing the registration of a disposition unless the grantee certifies that the terms of the right of pre-emption have been complied with. It has been held by the Adjudicator to the Land Registry that the grantee of right of pre-emption granted before the 2002 came into force is not entitled to enter a restriction because he has no property interest (before the right is triggered); see **Highland Loughborough Ltd v Metrobrook Ltd** [2007] EWLandRA 2005_1186. However, if the grantor consented to an application to enter a restriction it is unlikely that the Land Registry would refuse to give effect to the application.

75. Even entry of such a restriction would not prevent registration of a mortgage because the mortgage would not trigger the right of pre-emption. Nor would it prevent the registration of a notice in respect of a subsequent option. So a restriction would only provide a degree of protection – but it would be better than nothing.

Rights granted after the commencement of the LRA 2002

76. Protections for rights of pre-emption over registered land, granted after the LRA 2002 came into force, are capable of and should be protected by a notice. Again an agreed notice is preferable but a unilateral notice can easily be obtained as an alternative if there are difficulties. In addition a restriction should be entered wherever possible so it is desirable to make express provision for a restriction in the grant of the right.

77. Such rights contained in registerable leases are required to be set out in the prescribed elements of such leases: prescribed clause leases. By that route, if properly completed, they will be clear to the register who will make the appropriate entries against all relevant registered titles.

Overage Agreements and Arrangements

More Detail

78. A landowner and a developer may simply agree the transfer of the land to the developer at a lower price than the landowner wants but with a subsequent further payment of a share of the profits to the landowner. The promise to pay that future sum will operate as a simple contract, enforceable against the developer as a debt in the usual way. However, such an arrangement will not create any other rights or obligations and therefore carries no entitlements or remedies directly referable to the land. Such an arrangement carries no protection against the insolvency of the developer, the failure to develop or the disposal of the land by the developer without realizing the profit leaving a third party (possibly associated with the developer) free to take all the profits without accounting back to the original landowner. Where overage arrangements are made it is therefore prudent and usual for the landowner to look for more security prior to handing over the goose that is to lay the golden egg.

79. Obtaining guarantees for payment from an associated or parent company can provide an extra avenue for chasing payment. However, that route suffers from the same essential weakness that the obligations to pay are unconnected to the golden egg/the land.

80. By entering into a positive covenant to pay overage, the parties extend the applicable limitation period and open up a number of possible mechanisms for securing compliance with overage provisions.

Drafting Points

81. Points to consider when drafting an option include:-

Trigger

- Event or time defined

Precision

vague

- Single or multiple

Long stop date

Calculation of overage

- Date of evaluation
- Allowances/expenses
- Formula
- Dispute resolution

Date for

- liability to raise
- payment

82. The decision in **Harris v Berkeley (Strategic Land) Ltd** [2014] EWHC 3335 highlights the competing benefits and disadvantages of precision and vagueness in drafting the trigger event in an overage provision. The ordinary contractual principles of construction and rectification apply. In **George Wimpey v VI Construction**[16] an attempt to obtain rectification for unilateral mistake failed because the necessary knowledge and/or dishonesty on the other parties' part was not established.

83. With the decision in **Yam Seng Pte Ltd v International Trade Corp Ltd** [2013] EWHC 11 there is a possible greater willingness to imply a duty of good faith into some commercial contracts. The sort of contracts focused on were long term relational contracts involving a shared purpose and/or necessary element of trust, fidelity and/or confidence between contract. A duty of good faith has been recognised in the context of overage; **Ross River v Cambridge Football Club** 2007 EWHC 2115. In that context the duty was to give proper disclosure to facilitate the calculation of an overage payment. Since there is a possibility for an extension of the good faith duty it worth considering express provisions that provide limits for such duties in overage agreements.

84. **Walton Homes Ltd v Staffordshire County Council**[17] is another example of the use of an expert to determine a dispute pursuant to a dispute resolution clause which went wrong for one party. Again the "manifestly erroneous" test proved too high to enable the losing party to appeal.

[16] [2005] EWCA Civ 77

[17] [2013] EWHC 2554

Protection

85. Aside from ensuring any arrangement as drafted anticipates what may in fact happen with the land in light of the vagaries of planning, the property market and finance, securing the interests of both parties presents the biggest difficulty. There are no easy options and plenty of pitfalls for conveyancers[18]. Developers will want to have flexibility in their projects so that they can raise funding or sell a project on, whether before completion or at the end. Of course, the ultimate aim is always disposal of the land and it is at that point the money is generated. Developers also need flexibility to raise finance as and when required. Meanwhile the vendor wants to be secured so that, when the profit in the development is actually generated and realised, the entitlement to a share of the profit is enforceable against the person whose has the money. Changes of developer in the course of the project are not unusual, and present further problems.

86. Generally the burden of positive covenants does not run with land. As a result positive covenants on their own are generally deemed inadequate, like simple contractual obligations. However, there are a number of exceptions to the rule that the burden does not pass, some of which should be understood in this context. The two of particular interest are rent-charges and rights of re-entry.

87. Where the further payment is simply a fixed additional sum, treating it as part of the purchase price giving rise to a vendor's lien, rather than as overage may make sense unless the tax implications are prohibitive[19]. In that case the vendor's lien should be protected by a notice[20], as actual occupation (in the LRA 2002 sense) will be required for protection as an overriding interest. However, such protection can inhibit the developer's lending capacity.

88. There are various ways of structuring an agreement to share the profits out of a proposed project, as to which see below.

[18] Akusuc Enterprise Ltd v Farmar Shirref [2003] EWHC 1275

[19] SDLT is payable on the full purchase price at the date of sale or where it is not known on the basis of a reasonable estimate.

[20] Although an agreed notice could be obtained the parties are unlikely to want to the full details of the deal to be public and an unilateral notice is more likely to be appropriate

89. Each way has its advantages and its problems. Overage does not exist in a law as a separate topic. Transactional lawyers have used a range of techniques that were not designed for that purpose, to meet the needs of their landowning and developer clients. Neither Parliament nor the Courts have, as yet, stepped in to develop a coherent legal format to meet this key commercial, economic and social need.

90. The Courts struggle with balancing the purposive approach to interpreting contracts, seeking to give effect to the commercial purpose of an arrangement, and the need to give effect to the overriding rules of law where a device "misuses" a traditional legal concept to achieve a commercial purpose (see restrictive covenants in particular). Generally the Courts can be seen to be trying to strike an appropriate balance between landowner and developer, reflecting their commercial intentions without completely ignoring the overriding legal principles.

Chain of covenants

91. The most common mechanism for enhancing the positive covenant route is coupling it with a covenant by the developer not to transfer the property without first procuring a covenant from the purchaser in the same terms and co-operating in the registration of a restriction on the title of the property. A restriction can be placed on the register to ensure compliance with that obligation[21]. It is wise to anticipate that requirement and include a requirement in the sale contract that the developer register a restriction against his title immediately.

92. This is a very commonly used mechanism and has the attraction of being relatively simple, in theory at least. However, drafting a provision that covers all eventualities is very difficult and insolvency can often result in the chain being broken. Further there is an, as yet untested, argument that the use of a restriction in this way falls foul of the statute Quia Emptores 1290, which is the origin of the English Law that land held in fee simple can be disposed of freely and without restriction.

[21] Current Land Registry Guidance supports the idea that a restriction can be used in this way – Practice Guide 19 – Notices, restrictions and the protection of third party interests

Release of Restrictive Covenants

93. The burdens of restrictive covenants, unlike positive covenants, do pass with the land, and in that sense provide a far more meaningful vehicle for achieving the aims of those seeking overage arrangements. Restrictive covenants have been a very common mechanism used where the conditions allow. They operate by the imposition of a restrictive covenant against development or user on the basis that the vendor will agree to relax or release the covenant in exchange for a fee which will be his overage payment. However, this mechanism has a number of possible pitfalls. Very worryingly the judgment in **Cosmichome** included a conclusion that a restrictive covenant that had an express provision for release on the payment of overage did not in fact operate as a restrictive covenant. The conclusion was that the restrictive covenant was there to support the overage not to benefit the land. It follows the use of that mechanism must be the subject of very careful consideration.

94. The advantages, for property lawyers, of using restrictive covenants including the fact that they are covenants rather than simple contracts, they are a well understood and explored legal concept. If a covenant is a restrictive covenant properly so called, annexation to the land and the binding of the developer's successors happens automatically. There are no perpetuity problems. They are easily protected by notice on the register.

95. However, in order for the burden of restrictive covenant which runs with the land to be enforceable against the developer's assignee, the benefit of a restrictive covenant must be attached to land retained by the vendor. However, overage has nothing to do with the amenity of the land. It follows the use a restrictive covenant used in this way is a devise and completely at odds with the true nature of restrictive covenants. That distortion of the purpose and nature of restrictive covenants can leave the vendor relying on the restrictive covenant as a device to ensure payment very exposed to the risk a court will not assist. The tension between the true purpose of restrictive covenants and the real purpose in the particular instance creates a significant legal issue and a number of practical problems.

96. The legal problem is that **Cosmichome** concluded that a restrictive covenant in a deed that also contained a provision for its release on the payment of overage was

not in fact a covenant that run with land that was originally sold land because its true purpose was the securing of the overage payment rather than the protection of the land itself. The reasoning in **Cosmichome** must be taken to put all such arrangements at risk. If the restrictive covenant has a wider scope than the circumstances in which it can be released and the two are in different documents and created at different times the mechanism may well work. However it must be appreciated the courts are increasingly not keen to enforce property rights that are being used as a "device" rather than for their own sake.

97. Even if the arrangement does create a restrictive covenant there may still be difficulties. Restrictive covenants exist for the purpose of protecting the amenity of land, expressly not for the purpose of extracting cash from the new owner of land. Restrictive covenants are used as an overage mechanism on the basis that the developer will pay in order to secure release from the covenant. If the ability to enforce is lost or compromised the prospects of securing a payment are similarly compromised. In principle anything that inhibits someone's ability to secure an injunction against a breach of the covenant is unhelpful, although that is mitigated by the fact that the Courts' approach to damages is to award damages which reflect the sum that might have been paid for release following a hypothetical negotiation.

98. The vendor is therefore in difficult territory. If in truth the vendor contemplated and wished for the breach, he stood by whilst the breach occurred and the breach may not in reality damage the amenity of his retained land. Any indication that someone is not seeking to enforce their right and would take a cash sum instead will be taken into account in considering whether to grant an injunction or in the alternative to award damages[22]. Any actual diminution in value is taken into account in assessing damages on the basis that in the hypothetical negotiation the damages suffered by the vendor and the profit made by the developer will be the major factors. The parties' actual negotiations may amount to waiver of the breach, or at least a waiver of the right to specific performance. A waiver may impact adversely on the level of damages. Where the parties' negotiations as to a release fee are without prejudice and incomplete, the sums discussed will not be before the Court. However, where there is a concluded agreement about a release

[22] Gafford v Graham (1988) 99 P&CR 266, Harris v Williams-Wynne

fee or an open negotiation they will be before the Court. It not yet clear how the Courts will approach such evidence. At some point the Courts will have to give guidance. If they conclude where an agreed release fee exists damages should reflect the actual agreement, the utility of restrictive covenants for overage will be enhanced to that extent.

99. The practical difficulty for the enforcing vendor is that there may be a significant delay and he may wish to dispose of his retained land or part of it. If he disposes of his retained land that benefits from a restrictive covenant to secure overage he will not be able to enforce against the developer's successors. If the vendor disposes of parts of his retained land he may find his ability to enforce, and therefore the rewards, are shared with others. That would inevitably reduce the sums the developer would pay him.

100. The huge additional fly in the restrictive covenant ointment is that there is, of course, power in the Lands Tribunal to discharge or modify a restrictive covenant[23]. The reality of the overage arrangement and the intention behind it may well create an easy route to discharge or modification without the need to comply with the overage arrangement. In very valuable developments where overage payments are substantial a developer may seek to avoid an overage payment secured by restrictive covenant by making just such an application. There is nothing to inhibit the making of such an application where an overage arrangement dependent upon the restrictive covenant exists.

101. Usually the overage if the only reason the restrictive covenant was imposed and that is not a valid purpose so far as s84 is concerned. Where in truth there is no significant amenity to protect or the development has so changed the area that the covenant is obsolete a restrictive covenant is vulnerable to discharge. The payment of overage money is not a practical benefit that would justify the retention of a restrictive covenant that unreasonably impeded reasonable use. Further an completed agreement to release a restrictive covenant upon payment of a certain sum would make a restrictive covenant vulnerable to release by the Land Tribunal on the basis there is agreement to its release without necessarily imposing the obligation to pay. Given the power of the Lands Tribunal the value of overage

[23] s84(1) Law of Property Act 1925

arrangements organized via restrictive covenants may in truth come to reflect their nuisance value rather than a negotiated division of the profits.

Rent Charges

102. As referred to above, the use of rent charges may be thought to be a possible solution, but it is problematic because the creation of rent charges other than estate rentcharges is prohibited by the Rentcharges Act 1977. Estate rent charges are defined by s2(4) of the 1977 Act. An estate rentcharge created for the purposes of overage would have to provide for a peppercorn rent annually and a substantial sum in the year of planning permission or development followed by the cessation of the rentcharge. Such an estate rentcharge is arguably unlawful and prohibited under the 1977 Act. Not surprisingly, although some commentators suggest rentcharges are an option they are untested.

103. The idea is that although the obligation to pay does not pass to a successor the right to re-entry may be exercised against a successor, as with forfeiture against a current lessee for a previous lessee's failure to pay service charges. Such a right in respect of unregistered land cannot be protected; the ability to enforce is wholly dependent upon the successor having actual notice of the right to re-enter[24]. Further, the Courts retain an inherent equitable discretion to grant relief from the exercise of such a right. The legal context is complex and unfamiliar and requires very careful drafting. Perpetuities and the impact of adverse possession/limitation can undermine them in the longer term. As a result this is not a common technique although it is favoured by some.

Mortgage and Charges

104. A simple contractual obligation or a positive covenant to pay overage may be secured by a mortgage or charge. Nevertheless such an approach will rarely be of assistance as the developer will want the freedom to raise funds uninhibited by the presence of such a charge. The developer's lender is unlikely to accept the original owner's charge as having priority and it is the nature of development funding that both lender and developer will be looking for flexible funding with the capacity for further lending if needed. If it is possible to put together such a deal it is likely a deed of postponement of the vendor's charge but acknowledgement by the lender will be necessary, along with provisions for the postponement of the right to redeem.

[24] Shiloh Spinners v Harding [1973] AC 691

105. Some would argue that such an approach is problematic because the sum payable or conditions for payment may be uncertain or the charge would operate as a clog on the equity of redemption given the inability to redeem until the trigger date. Such arguments are unlikely to succeed provided there was equality of bargaining power. However, if it became necessary to bring a redemption action, the Court would determine how much is required to redeem. That figure would be the value of the right to overage (taking account of the right and the associated risks) and not simply what the overage payment would be.

106. If the overage period is 12 years plus, the original owner's interests may be extinguished by the operation of limitation in light of the developer's occupation without payment.

107. If a developer is insolvent before the obligation to pay overage arises, a landowner will find himself losing out, even if the charge entitled him to seek an order for sale in the event of insolvency[25].

Lease and Surrender

108. A developer may be granted a lease of premises with an option to acquire the freehold upon payment of a premium. The overage payment may be structured via rental payments or the premium on the exercise of the option. Covenants in leases, even if positive, run with the land and are enforceable by forfeiture (peaceable or by action). Such an arrangement gives the original owner a high degree of control and security. A degree of control and interest that a developer and its lender may well not be comfortable with.

109. The lease required will be complex if it is to give the flexibility required for the development. If the retention of the freehold and the existence of the lease are to continue beyond the disposal of some developed units to third parties, a complex network of underleases would be required. The practicalities inevitably increase the costs for everyone and introduce risks and confusion that may be too great a disincentive.

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[25] Groveholt Ltd v Hughes [2005] EWCA Civ 897

110. An alternative is the grant of a lease back or an agreement for a lease back to the original owner subject to an obligation to surrender upon payment of a premium being the overage payment.

111. Both lease arrangements involve a device which does not reflect the parties' aims. The original owner does not really wish to have a lease of all or part of the developed land, nor does he have any interest in being in a network of ownership with any of the third party ultimate purchasers.

Option Back

112. The grant of an option to the original owner to purchase back the land, at a heavily discounted price, after a designated trigger event if the overage payment has not been made is another potential device. Again, the device does not reflect the parties' aims; rather it achieves the opposite of the parties' aims but is used to provide an incentive for the orderly payment of overage. The option would need to be protected by a notice on the register. Generally lenders are not keen on such arrangements. If land is or may be land-banked for anything approaching 21 years it is necessary to have regard to the impact of the perpetuity period, at least in respect of arrangements pre-dating the 2009 Act.

113. In reality the original purchaser has no desire to have his land back, wanting his cash instead. Being faced with raising funds to purchase the land back and then sell it on in order to attempt to realise the intended overage payment/additional payment would never be an attractive prospect. In the current climate it may be financially impossible for the original purchaser to exercise the option and secure his additional return in any event.

Ransom Strips etc

114. Where the layout of the land permits, one of the most powerful mechanisms for securing overage provisions is the retention of a ransom strip. The vendor can retain ownership of the ransom strip and grant the developer only such rights as are required to enable the pre-payment activity to proceed. The physical attributes of a site may not permit that option. Even where the layout permits, the impact on value is likely to be such that it seriously affects the ability to raise funds on the land sold.

115. If a ransom strip is used and the parties cannot agree the ultimate overage, the power of the ransom strip will be subject to the usual principles so far as rights of necessity, the operation of s62 and injunctive relief and damages are concerned. It follows that a developer may be able to secure the minimum rights needed without satisfying the intended overage obligation. As yet there is no clear guidance from the Courts as to the approach to be taken where there is before the Court a deliberate ransom strip created to ensure the payment of overage and the arrangement breaks down.

SPVs

116. An overage arrangement can be achieved by transferring the land into a corporate or trust vehicle and operating the development as a joint venture with vendor and developer as participants. Generally the vendor who is looking to find a way of securing a bit of extra profit from their land will not want to be involved in such a complex arrangement that imposes potential obligations and liabilities on him. Further a developer will generally not wish to give the vendor that much involvement in the control and administration of the project.

Prepared by

Brie Stevens-Hoare QC & Simon Allison
Hardwicke