Falcon Chambers

DISREPAIR DURING THE TERM OF THE LEASE

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by

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Introduction

1. A tenant's liability for terminal dilapidations is a subject that is well understood, if contentious. The remedy is in damages alone, about which much has been written. By contrast, there is rather less learning regarding a tenant's liability for dilapidations during the term. Although the landlord has a much wider range of remedies available to it, all these have their flaws, as this paper examines.

2. The remedies are, in no particular order:
   (a) Forfeiture;
   (b) An action for specific performance;
   (c) Carrying out and charging for the requisite remedial works;
   (d) An action for damages for breach of repairing covenant.

The remarks in this paper are directed at non-residential premises. We also concentrate on the remedies available to landlords rather than tenants.

(a) Forfeiture

3. The threat of forfeiture ought in theory to be enough to persuade a recalcitrant tenant to remedy its breaches of covenant. But in practice, a tenant carrying on a business is unlikely to want to suffer the disruption that building works will cause, particularly since it will have to carry out terminal dilapidation works at some later stage. It is therefore likely to use every means at its disposal to contest a threatened forfeiture.

4. At any stage before the last three years of the term, the tenant will have available to it the protection afforded by the Leasehold Property (Repairs) Act 1938. The policy of that Act is to prevent the landlord from obtaining or threatening to obtain relief against the tenant greater than that required to protect his legitimate interests: National Real Estate and Finance Co Ltd v Hassan [1939] 2 KB 61. If the Act applies, the landlord must serve notice upon the tenant alerting it to its rights, and if the tenant serves a timeous counter-notice, the landlord may only take forfeiture proceedings or sue for damages if it is granted permission by the court. Such permission is only granted where the landlord proves that the immediate remedying of the breach of repairing covenant is required in order to

save the landlord from substantial loss or damage which it would otherwise sustain.

5. That is a high hurdle for landlords to surmount, particularly where the outstanding term of the lease is substantial. In Associated British Ports v C H Bailey Plc [1990] 2 AC 703, a 26,000 square yard commercial dry dock in Barry, Glamorgan had been leased in 1955 for a term of 99 years at a fixed annual rent, on full repairing terms. As a result of a decline in demand for ship repairing, the dry dock was not used after 1983 and the fixtures and machinery fell into disrepair. It was doubtful whether the dry dock would ever be brought back into use as a dry dock, and it was likely that anyone who in the year 2049 wished to carry on the business of ship repairers or any other business on the demised premises would construct entirely new buildings and install modern machinery and equipment.

6. These considerations notwithstanding, in 1987 the landlords served on the tenants a notice under section 146 of the Law of Property Act 1925 together with a schedule of dilapidations, the cost of compliance with which would have been over £600,000 (say £2m in today's terms). The tenant's evidence was that the diminution in value of the landlords' reversion attributable to the present state of disrepair was £3,500. It was abundantly clear that if the lease were enforced according to its express terms, the lease would be forfeited and the tenants held liable to pay heavy damages.

7. The House of Lords devoted its reasoning to the proper functioning of the Act, and the way in which matters arising should be proved. But what is of significance for our purposes is Lord Templeman's dictum that:

> "it would be open for a judge in the exercise of the discretion conferred on him by section 146 of the Act of 1925 to grant relief against forfeiture of a lease with nearly 60 years to run without requiring the tenant to spend over £600,000 without substantial benefit to anybody".

In other words, a judge hearing a forfeiture action for breach of repairing covenant does not have to impose as a term of relief that the remedial works should be carried out.

8. We have become used to this dictum, but at the time it was startling in its novelty. With that dictum, landlords seeking to use forfeiture as a means of oppression, and without proper reason, lost their bargaining position. Now, if a landlord seeks to forfeit mid-term, it needs to prove on the balance of probabilities why it is necessary for the remedial works to be done there and then, instead of at the end of the term. This has undoubtedly lessened the force of forfeiture as a means of getting the works done.

(b) Specific performance

9. For many years, it was considered that, with very limited exceptions, a court would not entertain an action to compel performance of repairing covenants. By 1999, however, this "rule" had become unsustainable. In that year, the High Court in Rainbow Estates Ltd v Tokenhold Ltd [1999] Ch 64 became the first to make such an order against a tenant. The premises in question comprised Gaynes Park Mansion in Epping, a grade II listed building which had fallen into disrepair.

10. The judge held that the modern law of remedies requires specific performance of a tenant's repairing covenant to be available in appropriate circumstances, although it would be a rare case in which the remedy would be the appropriate one: in the case of commercial leases, the landlord will normally have the right to forfeit or to enter and do the repairs at the expense of the tenant. However, there were no such provisions in that case, and it was appropriate that an order be granted.

11. The remedy of specific performance will therefore be extremely limited in its application, for the vast majority of commercial leases contain forfeiture or entry provisions. Forfeiture has been considered above; entry provisions are next on our list.

(c) Carrying out and charging for the requisite remedial works

12. In Jervis v Harris [1996] Ch 195, a tenant under a 999 year lease granted in 1947 covenanted to maintain premises in good tenantable repair and condition. The lease authorised the landlord to enter the premises to view the state of repair and to give notice in writing to the tenant of any defects or want of repair, which the tenant was required within three months to make good. In default, the landlord could do the work and recover the costs and expenses from the tenant. Following inspection and service of notice by the landlord, the tenant failed to carry out repairs, and refused the landlord or his workmen entry. On the trial of preliminary issues the judge declared that the covenants were enforceable and that a claim by the landlord to recover moneys expended on repair was a claim for a debt and not for damages for breach of a covenant, and was therefore enforceable by the landlord without first obtaining the leave of the court under section 1 of the Leasehold Property (Repairs) Act 1938.

13. The tenant appealed. The Court of Appeal held that, where a lease provided by specific covenants for repairs to be carried out by the lessee, in default of which the lessor was entitled on notice to enter the property and carry out repairs at the lessee's expense, a claim by the lessor to recover moneys expended in making good a want of repair arising from the lessee's breach of the repairing covenant was a claim for debt and not a claim for damages for breach of covenant; that the doctrine of penalties did not apply to a claim in debt; and that, therefore, the leave of the court under the 1938 Act was not required before the landlord could enforce his claim against the tenant.

14. The decision, if correct, has devastating consequences.

15. First, it evades the protection which Parliament saw fit to confer upon tenants held at ransom by unscrupulous landlords threatening to sue for damages for dilapidations when the landlords would suffer no actual loss – see section 18(1) of the Landlord and Tenant Act 1927 and the Leasehold Property Repairs Act 1938.

16. Secondly, it also helps to legitimise end of term clauses which require the tenant to pay the landlord the estimated loss of remedial works which the landlord may never carry out (see paragraphs 20 to 33 below).

17. Thirdly, recognising the arguable unfairness of its application, courts adopt a restrictive construction to clauses allowing entry. See for example the judgment of Neuberger J in Amsprop Trading Ltd v Harris Distribution Ltd [1997] 1 WLR 1025:

> "a provision such [a Jervis v Harris] clause, which gives the landlords substantial powers, and in particular the power to carry out work at the tenant's expense, should be construed narrowly rather than widely."

18. Fourthly, it is of little practical use. A landlord will only need to use its JvH powers when its tenant has proved resistant to carrying out repairs – and the landlord should therefore expect opposition:

(1) First, the tenant may well challenge the landlord's notice, which usually has to satisfy certain contractual stipulations;

(2) Secondly, the tenant may argue that the work is unnecessary, rendering it imprudent for the landlord to proceed without obtaining court sanction (which would of course defeat the utility of the remedy).

(3) Thirdly, tenants may succeed in preventing the use of JvH powers. In Hammersmith and Fulham LBC v Creska Ltd (No.2) [2000] L & TR 288, Jacob J refused to grant an injunction requiring the tenant to allow the landlord access to carry out works under such a clause, even though the landlord had complied with it to the letter.

(4) Fourthly, even if the landlord does prevail in obtaining entry to carry out works, its troubles are far from over. It may, for example, find that more work is required than was specified in its notice; or it may encounter problems in carrying out the work, the cost of which the tenant will be likely to challenge.

19. In all those circumstances, the practical utility of Jervis v Harris clauses is questionable.

Liquidated damages clauses for end of term liability

20. Actions for damages for terminal dilapidations have a statutory cap imposed upon them by s.18(1) of the Landlord and Tenant Act 1927. Many draftsmen have tried to circumvent this by including provisions to the effect that the tenant must pay the cost incurred by the landlord in remedying breaches at the end of the term, together with the loss of rent and other financial losses referable to the time the premises are out of commission as a result of the works.

21. If the provision in question is drafted as a covenant entitling the landlord to recover damages, then it will be well arguable that this too will be simply an indirect claim for damages for a breach of a covenant or agreement to leave the premises in repair at the termination of a lease. However, suppose that the provision is worded in the same way as a JvH clause, allowing the landlord to recover in debt, rather than damages – does that work?

22. There is no authority on the point in England and Wales. In Scotland (where there is less statutory intervention, and no equivalent of s.18(1)), the jurisprudence is rather more developed. Two authorities illustrate the development in the law.

23. First, in Grove Investments Ltd v Cape Building Products Ltd [2014] CSIH 43, a lease included the following obligation:

> "The tenants bind themselves … to pay to the landlords the total value of the Schedule of Dilapidations prepared by the landlords in respect of the tenants' [repairing] obligations … declaring that the landlords shall be free to expend all moneys recovered as dilapidations as they think fit and the tenants may, with the prior written agreement of the landlords, elect to carry out the whole or any part of the said Schedule of Dilapidations but that provided such work is completed to the landlords' reasonable satisfaction".

24. Towards the end of the term, surveyors acting for the landlords served a schedule of dilapidations, instancing works costed at a sum exceeding £10m. When the tenants failed to carry out the works, the landlords issued proceedings claiming damages in that amount.

25. The tenants submitted that on its proper construction the relevant clause meant that they were only obliged to make payment to the landlords of the loss actually suffered by them in consequence of the tenants' failure to implement their repair and maintenance obligations; and that to construe the clause in the manner contended for by the landlords might result in a recovery that bore no relation to any loss in fact suffered by the landlords as a result of the tenants' breaches.

26. The Inner House of the Court of Session held that the tenant's argument was correct, and the drafting of the provision had not ousted the need for the landlord to prove actual loss at common law.

27. Secondly, in SIPP Pension Trustees v Insight Travel Services Ltd [2016] 1 P & CR 17, the court had to construe a lease containing a clause in these terms:

> "if the Landlord shall so desire at the expiry or sooner termination of the foregoing Lease they may call upon the Tenant … to pay to the Landlord at the determination date … a sum equal to the amount required to put the leased subjects into good and substantial repair and in good decorative condition in accordance with the obligations and conditions on the part of the Tenant herein contained in lieu of requiring the Tenant himself to carry out the work."

28. The landlord claimed such a sum from the tenant, amounting to £1,261,303.50. The tenant resisted the claim on the basis that there was no evidence that the landlord intended to carry out the requisite remedial work, and in any event that the value of the premises did not warrant the expenditure, in that the capital value would increase by a far lesser amount if the works were done.

29. At first instance, the Lord Ordinary agreed with the tenant, and construed the provision as being an obligation to pay for the cost of the works that was conditional upon the landlord intending to carry out the repair works, and not as a liquidated damages provision.

30. The landlord appealed. The Court of Session, Inner House, allowed the appeal (distinguishing Grove), on the footing that the provision was a payment

clause and not a damages clause; that the sum due was the estimated repair cost; and that questions of whether and to what extent the premises were worth less in capital terms were irrelevant.

31. The position in Scotland therefore appears to depend upon precisely how the provision is drafted. There is no consideration of the statutory cap (although in practice the courts bear in mind similar general principles informing recoverability of damages).

32. Could such a clause work in England and Wales? It might be said that if JvH clauses have the effect during the term of enabling landlords to recover the cost of repair irrespective of contribution to value, the same should apply at the end of the term. However, at least in JvH cases, the landlord has to carry out the work in order to recover its loss – whereas in SIPP, there was no evidence that the landlord intended to do anything.

33. The safe advice must be that such clauses may well "work" in this jurisdiction – but only if the landlord actually does the work. But that is usually the position with a conventional repairing covenant too – so no great advance there. We may have to wait a very long time before a court in England and Wales decides that a terminal JvH-type clause enables the landlord to recover the notional costs of work it does not intend to carry out.

(d) Mid-term claims for damages for breach of repairing covenant

34. Such claims are very rare, for a number of reasons.

35. First, in the case of leases to which the Leasehold Property (Repairs) Act applies, the landlord will have to comply with the notice procedures and potentially obtain the leave of the court (see paragraph 4 above) before proceeding. Leave will only be given if the breach is serious and such as to cause a severe diminution in the value of the reversion – which may be thought to be unlikely in view of the point made in paragraph 37 below.

36. Secondly, the old common law measure of the cost of works cannot apply, not least because the landlord cannot carry out any works while the lease is running. Moreover, the Landlord and Tenant Act 1927 imposes a ceiling upon the level of the recoverable damages equal to the diminution in the value of the reversion.

37. It is very difficult to see how the landlord could prove any diminution – for the simple reason that its tenant remains in possession under a full repairing covenant, to which the landlord could have recourse at the end of the term.

38. Similar arguments are raised when a full repairing lease terminates, with a subtenant remaining in place on a new lease of part or whole. In Family Management v Gray (1979) 253 EG 369 two building leases had been granted in January 1887 for terms of 90 years, of adjoining premises in South Lambeth Road in London, which, in the words of Shaw LJ "was then a neighbourhood of higher standing and amenity than it is at the present time".

39. Towards the end of the leases in 1974, the ground floors of each set of premises (a dry cleaner and a delicatessen) were occupied by businesses under full repairing underleases. The premises were in some disrepair.

40. A proper understanding of the chronology of subsequent events is critical to an understanding of the case:

(a) in June 1974, that is some six months or so before their respective leases were due to expire, the business subtenants of the shops on the ground floor were served with section 25 notices by the head landlord, Family Management, indicating that it would not object to a renewal of the tenancies under the Landlord and Tenant Act 1954;

(b) the subtenants then negotiated new leases for 20 years, again on full repairing terms;

(c) no repairs were ever carried out, but in 1976 Family Management took proceedings against the former tenant, Mr Gray, for £6,500 damages for breach of his repairing covenants

41. Evidence was called at trial to the effect that the cost of putting the premises into proper condition on the covenants would have been about £6,000. The court instead awarded damages of £1,600, based upon an annual loss of rent of £100 for each shop, compounded over the new terms.

42. Family Management appealed. The Court of Appeal held, allowing the appeal, that the damage to the head landlord's reversion was nil or de minimis, because in negotiating their new rents after 1974, the sub-tenants were prevented by s.34 of the 1954 Act from alleging their own default in repairing obligations in order to reduce the rent. Since they had had full repairing obligations to Family Management, their new rents could not have been reduced by reason of dilapidations.

43. This decision has been much used and abused. It is not authority for the proposition that, whenever a head tenancy expires with sub-tenants in occupation, the diminution in the value of the landlord's reversion will inevitably be nil, thus negating any dilapidations recovery.

44. The limitations of the principle espoused by the Court of Appeal appear in the following passage of the judgment of Shaw LJ (with whom Waller and Megaw LJJ agreed):

> "… that there were leases in prospect and that there was a right on the part of the sublessees to look for new leases, and that the chances were that they would arise by negotiation or be granted by the court was a reality which ought and had to be recognised."

45. So, whether there has in fact been any diminution in the value of the reversion where a sub-tenant remains in occupation will depend upon whether:

(a) the sub-tenant itself has a full repairing lease, or at any rate one which mirrors the repairing liability under the headlease;

(b) the premises occupied by the sub-tenant form all or part of the premises demised by the headlease;

(c) the probability that the sub-tenant will in fact renew its tenancy.

46. Since Family Management, a number of cases have explored the same area. In Lyndendown Ltd v Vitamol Ltd [2007] 3 EGLR 11, at the time the lease expired, a subtenant remained in occupation under a full repairing lease, with rights under the 1954 Act. The appeal concerned other matters, but it was common ground that there was no diminution in the value of the reversion. As Lawrence Collins LJ said:

> "The fact that the premises are occupied by subtenants under tenancies to which Part II of the 1954 Act applies must be taken into account in assessing the damage to the reversion. The subtenant will become the direct tenant of the landlord on the expiry of the head tenancy: see section 65 of the 1954 Act. The landlord will therefore become entitled to the benefit of any obligations to repair in the subtenancy. The subtenant will become entitled to a new tenancy under the 1954 Act and the new lease will prima facie be on the same terms (including repairing covenants) as the existing tenancy, and the rent will be fixed by the court without taking account of any disrepair that is attributable to the subtenant's breaches of the repairing covenants in the current tenancy."

47. Reverting to the case of the tenant itself being sued for mid-term dilapidations, these considerations will not apply. The only germane question will be whether the landlord can establish a diminution where its covenant remains intact. The answer to that is a question of fact, with an uncertain outcome for the landlord.

Conclusions

48. None of the landlords' remedies discussed above is trouble-free. All have benefits; all have disadvantages. In every case where action is being considered, there needs to be close teamwork between the landlord and its advisers to decide on the best way forward.

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