

# Dilapidations

## *Topics of the moment*

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**Guy Fetherstonhaugh QC**  
**FALCON CHAMBERS**

### **Introduction**

1. Leases that impose repairing liability upon tenants create obvious conflicts of interest between landlords, who expect their premises to be returned to them in a fully lettable state, and tenants, who do not expect to have to fund the cost of updated premises which they were never able to enjoy. This conflict has caused disputes over the centuries which show no signs of abating.
2. This paper deals with some of the areas of repairing liability which continue to cause contention:
  - (a) The liability of a head tenant who vacates leaving a subtenant in occupation;
  - (b) Liability for removal of fixtures;
  - (c) Operation of Jervis v Harris clauses;
  - (d) Liquidated damages clauses for end of term liability.
- (a) **The liability of a head tenant where subtenant remains in occupation**
3. When a full repairing lease terminates, with a subtenant remaining in place on a new lease of part or whole, what is the landlord's position concerning terminal dilapidations under the expired lease?
4. Family Management v Gray (1979) 253 EG 369 concerned two building leases 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”.
5. 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.
  6. 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
  7. 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.
  8. 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.
  9. 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.
  10. 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.*”

11. 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.
12. Since Family Management, a number of cases have explored the same area.
13. First, in Crown Estate Commissioners v Town Investments Ltd [1992] 1 EGLR 61, the Commissioners had granted a long lease of business premises expiring in 1985, the term of which was vested in TI Ltd. TI Ltd had granted underleases of parts of the premises, which were vested in two parties at headlease expiry. As in the case of Family Management, new tenancies were granted by the Commissioners to the two sub-tenants.
14. At the expiration of the headlease, the property was in disrepair, and the Commissioners carried out repairs at substantial expense, the cost of which they sought to recover from TI Ltd. TI Ltd relied on the decision in Family Management and alleged that no damage had been caused to the reversion and hence by virtue of s.18 of the Landlord and Tenant Act 1927 the landlord’s claim was extinguished.
15. The Commissioners argued that Family Management was distinguishable on its facts, in particular that the repairing covenants in the underleases in the present case were principally concerned with interior repairs. Hence there was no direct correlation between these covenants and the (more extensive) repairing covenants contained in the headlease.
16. The High Court held that Family Management was authority for the following propositions when valuing a reversion which is not in possession but is subject to continuation tenancies under the 1954 Act:
  - (a) the court must take that fact into account as a reality and not treat the reversion as if it were in possession.
  - (b) the court must take into account all relevant matters relating to continuation tenancies which may affect the reversion value.

- (c) the court has limited power to admit evidence of matters which arise after the expiry of the contractual head tenancy.
  - (d) the court must assume that the rent will be fixed under the 1954 Act on the basis that the premises are in repair otherwise a tenant would gain an advantage from his own wrong if he is in breach of a repairing obligation.
17. On the facts, the decision in Family Management was distinguishable, owing to the lack of correspondence between the repairing covenants in TI Ltd's expired headlease and those in the expired underleases. It was therefore open to the Commissioners to call evidence at the full trial that the reversion had been damaged on that account. Further, the defence in Family Management did not apply to those portions of the building which had been vacated by a third sub-tenant.
18. Secondly, 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.”
19. Thirdly, in Van Dal Footwear Ltd v Ryman Ltd [2010] 1 WLR 2015, the tenant under full repairing lease remained in occupation of the premises at the end of the term, pending the resolution of negotiations for a new lease. Ultimately, however, the tenant vacated, leaving the premises in disrepair. In the subsequent dilapidations proceedings, the tenant claimed that the section 18 valuation ought to be conducted on the supposition that a hypothetical purchaser of the reversion would have received and accepted an offer by the tenant to take a new lease, and would have paid a higher

price accordingly. The Court of Appeal had no hesitation in rejecting this argument. In the words of Lewison J:

“... what the judge was required to do was to value the bundle of rights that the landlord actually had on the valuation date. On the valuation date the landlord did not have the benefit of an agreement for a lease with Ryman or even an offer capable of acceptance. Such offers as Ryman had made had been rejected, and in any event were made before the beginning of the hypothetical marketing period. ... If there is an actual special purchaser who exists in reality, no doubt his bid may be taken into account, but that does not justify the invention of a special purchaser.”

**(b) Liability concerning removal of fixtures**

20. It is readily assumed (and often it is correct so to do) that a tenant may remove fixtures installed by it at the end of its lease, but is not bound to do so. However, the precise rights and liabilities concerning fixtures can be altered by the terms of the lease between the parties. It is not unusual to find clauses (a) requiring the tenant to *remove* its fixtures; or (b) requiring the tenant to *remove* its fixtures *upon notice*; or (c) requiring the tenant to *not to remove* its fixtures. Such provisions trump what may be said to be the general position at common law. The difference in drafting may make a substantial difference in repairing liability at the end of the term (and of course to whether a tenant's option to determine has been correctly exercised – see for example the decision of Judge Saffman, sitting as a Deputy Judge of the Chancery Division, in Riverside Park Ltd v NHS Property Services Ltd [2017] L&TR 12.).
21. Whatever the contractual position may be, it will be critical to understand the difference between objects that may be (i) a chattel, (ii) a fixture, or (iii) an irremovable part of the premises.
22. Guidance as to the dividing line between (i) and (ii) was given by the Court of Appeal in TSB Bank Plc v Botham (1997) 73 P & CR D1.
23. More recent thoughts on the dividing line between (ii) and (iii) were offered by Morgan J in Peel Land and Property (Ports No. 3) Ltd v TS Sheerness Steel Ltd [2013] EWHC 1658 (Ch). That case concerned an enormous steel making plant and rolling mill, on a 50 acre site. The plant and machinery were such that their removal would take years, in some cases, cost millions

of pounds, and require the demolition of some of the structures housing them.<sup>1</sup>

**(c) Operation of Jervis v Harris clauses**

24. 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.
25. 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<sup>2</sup>; 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.
26. The decision, if correct, has devastating consequences.

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<sup>1</sup> In this regard, the landlord in Peel appealed (see the report at [2014] 2 P & CR 8). It did not seek to disturb the findings of Morgan J as to whether the items in question were fixtures. Instead, it appealed against the determination that the tenant's prima facie right to remove its fixtures during the currency of the term of the lease was not removed or modified by the provisions of the lease.

<sup>2</sup> Per Millett LJ: "The short answer to the question is that the tenant's liability to reimburse the landlord for his expenditure on repairs is not a liability in damages for breach of his repairing covenant all. The landlord's claim sounds in debt not damages; and it is not a claim to compensation for breach of the tenant's covenant to repair, but for reimbursement of sums actually spent by the landlord in carrying out repairs himself."

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27. 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.
28. 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 (d) below.
29. 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.”
30. 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 [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.
31. In all those circumstances, the practical utility of Jervis v Harris clauses is questionable.



**(d) Liquidated damages clauses for end of term liability**

32. Actions for damages for terminal dilapidations have a statutory cap imposed upon them by s.18(1) of the Landlord and Tenant Act 1927<sup>3</sup>. 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.
33. 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?
34. 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.
35. 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”.

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<sup>3</sup> 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 aforesaid; 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.



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36. 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.
37. 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.
38. 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.
39. Secondly, in SIPP Pension Trustees v Insight Travel Services Ltd [2016] 1 P & CR 17, the courts 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.”
40. 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.
41. 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.
42. 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.

43. 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).
44. 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.
45. 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.

**Falcon Chambers**  
**Falcon Court**  
**London EC4Y 1AA**

**GUY FETHERSTONHAUGH QC**

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