

## **VALUATION ISSUES IN TERMINAL DILAPIDATIONS CLAIMS**

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1. These notes contain our thoughts on some of the legal aspects of the valuation conundrums thrown up by our problems. They are bound to be far from comprehensive but, we hope, may be helpful as an aide memoire to the issues discussed during our workshop. Of course, these cases are fact specific, and we would obviously encourage you to seek legal advice on the specific facts of any given case. (We do not accept any liability to you or your clients for any advice given by you in reliance on these notes!)

### **Basic Principles**

2. In considering the damages payable in respect of any dilapidations claim, consideration needs (at least in theory) to be given to (i) the amount that would be awarded at common law and (ii) the effect of section 18(1) of the Landlord and Tenant Act 1927 (“section 18”).
3. At common law, the accepted measure of damage was for many years the reasonable and proper cost of putting the premises into the state in which they should have been left by the tenant (including professional fees), plus loss of rent for the period (if any) during which the landlord is unable to let the property by reason of the need to carry out works: see e.g. *Joyner v Weeks* [1891] 2 QB 31, CA and *Hansom v Newman* [1934] Ch 298, CA. In many cases, that measure will still be correct. However, it has been suggested more recently that, even before considering the impact of section 18, equating the cost of works with the damages in all cases is too simplistic – and that, even at common law, consideration must be given to whether it is

reasonable for a claimant to insist on recovering the cost of reinstatement rather than the diminution in value in his interest occasioned by the disrepair (which will in large measure turn on his intentions to carry out the work), and whether an allowance should be made, at common law, for supercession if some of the works which the tenants should have carried out would have been superseded by other works carried out by the landlord: see *Latimer v Carney* [2007] 1 P & CR 13, CA @ [24] (citing the principle established in *Ruxley Electronics & Construction Ltd v Forsyth* [1996] AC 344) and *PGF II SA and another v Sun Alliance Insurance plc and another* [2010] EWHC 1459 (TCC). If the common law measure alone were relevant to a landlord's claim, the courts today might in an appropriate case adopt the measure of damages in section 18(1) in preference to that which has previously been held to be the measure at common law: *Latimer v Carney* @ [60].

4. In any event, the common law measure is only a start point. Section 18 creates a statutory “cap” on the damages which can be recovered. It provides:

*“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 [the first limb]; 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 [the second limb]”*

5. Despite the fact that section 18 has been in force for 85 years, uncertainties as to precisely what it means and how it should be applied in particular

situations remain. Some of these will be explored in the problems below. In the discussion, we adopt the conventional split of the section into a first and second limb, as indicated in the text above. It is common to consider the two limbs separately because they incorporate 2 very different concepts:

- The first limb is objective. That means that the actual parties' wishes and positions have limited (but, as explained below, not necessarily no) relevance. The question is what the hypothetical purchaser of the landlord's interest would pay: (a) assuming the breaches had not been committed; and (b) for the premises as they in fact are. It is to be noted that the hypothetical purchaser may not necessarily be the same in each of the scenarios. The effect of the first limb, if engaged, is generally to reduce the damages payable (although if the evidence establishes that there is no diminution in value it could serve to defeat the landlord's claim altogether).
- The second limb is subjective, in the sense that what is here relevant are (normally) the actual landlord's plans for the building at the date the lease expires – that is whether he then intends to demolish or carry out significant structural work immediately or shortly thereafter. The effect of the second limb, if engaged, is to extinguish the damages claim altogether.

### **Suggested considerations in relation to Scenario 1**

#### *Overview*

6. The starting point will be the reasonable cost of the requisite works necessary to remedy RT's disrepair, plus any loss of rent etc.

*Loss of rent?*

7. However, as regards the loss of rent claim, it may well be that given the proximity of the term date of the Lease, it would not have been possible for T to relet the ground floor to a new residential occupier before the expiry of the Lease in any event. If the evidence points to that conclusion, a loss of rent claim is unlikely to be viable.
8. Query the position if T establishes that, but for RT's disrepair, T itself would have enjoyed beneficial use and enjoyment of the ground floor? (This might perhaps be rather more likely if all the floors of the building were configured and used for similar purposes, e.g. as offices.) In that scenario it may be arguable that T's loss of the value of the premises for the 6 month period would be recoverable. This would be akin to a conventional loss of rent claim.

*Section 18*

9. As for the impact of section 18, the relevant valuation/assessment date would be the expiry of RT's Sub-lease, namely 24.12.10.

Limb 2

10. The second limb of section 18 would almost certainly not be engaged here because no doubt at that date T (having only a fag-end interest in the premises and constrained by the terms of its own lease) would have had no intention whatsoever of pulling down the premises or effecting substantial alterations thereto which might render any repairs valueless.

Limb 1

11. So far as the first limb (diminution in value) is concerned, the following particular issues merit attention:

- a. What are T's proposals so far as carrying out the remedial work is concerned?
- b. Need one consider the intentions of the head landlord, L, if known? If so, on what date should one focus?
- c. What is T's "reversion" to be valued?
- d. Does it matter that T's reversion may itself (irrespective of RT's disrepair) have a negative value?

#### T's intentions

12. If, when T's claim is determined, it has done, or (if the Lease is still current<sup>1</sup>) intends to do, the relevant remedial works which RT ought to have carried out, this will be fairly strong evidence of the approach which would have commended itself to a reasonable hypothetical purchaser of T's reversion and thus of the diminution in value: see e.g. *Jones v Herxheimer* [1950] 2 KB 106; *Smiley v Townshend* [1950] 2 KB 311. In that situation the court may be prepared to infer that the disrepair led to a diminution in value of the reversion and the amount of that diminution from such circumstantial evidence.
13. What is more, even if T has not done, or has no plans (or ability) to undertake, the works, it does not follow that the cost of the works will be regarded as of little or no guide to the diminution in the value of its reversion. Although on the authorities (see e.g. *Craven (Builders) Limited v Secretary of State for Health* [2000] 1 EGLR 128) such a conclusion may well be drawn in the case of a claim brought by a freeholder, the position is, it is submitted, rather different where the claimant is a mesne landlord.<sup>2</sup> This is because, being subject to repairing obligations owed to the superior

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<sup>1</sup> E.g. if continuing under the 1954 Act.

<sup>2</sup> Who may in fact have no chance in practice to carry out the work, e.g. if his lease lasts just one day beyond the sublease and contains no *Jervis v Harris* clause.

landlord which are, in practical terms, of imminent consequence, T is not the master of its own destiny; rather, it is L who pulls the levers. The point is, whether or not T carries out the works, it does not have freedom of action. Unlike L, it cannot elect whether to repair or not scot-free. If T fails to comply with its repairing covenants, it shoulders a direct liability to L.

14. That said, if T has not done (and does not intend to do) the works, it will be incumbent on it (as claimant) to prove that the value of its reversion has nonetheless been diminished: see e.g. *Craven (Builders) Limited v Secretary of State for Health*. A landlord's conduct in taking steps or not taking steps to remedy a breach of a repairing covenant may throw light on the question whether the repairs are reasonably necessary, and thus on the question whether there is any diminution in value of the reversion as a result of the disrepair: *Latimer v Carney* @ [24]. So, if well-advised, T will adduce expert valuation evidence in such a case: *ibid.* @ [53], although the absence of expert evidence may not always be fatal, for it may be obvious that the disrepair must have caused some damage to the value of the reversion and that the cost of doing the repairs is a reliable guide to the amount of that damage, perhaps with a (potentially substantial) discount for any uncertainties as to whether the work will be done: see e.g. *Crewe Services & Investment Corporation v Silk* (2000) 79 P & CR 500, CA.
15. As regards the valuation evidence, any purchaser of T's reversion will surely reflect T's upward liability into its bid. The likelihood is that, with RT having left the retail space in a dilapidated condition, it will reduce its bid to take account of the fact that it is inheriting a liability owed to L which (so far as the ground floor is concerned) it would not have assumed (at least to the degree in question) had RT fully performed its duties. In practice, all other things being equal, this reduction is likely to accord with the costs of the works, i.e. what it would cost to put the subject premises in repair (T being beholden to L in that respect).

## L's intentions

16. In a case such as this it may also be necessary to take account of the head landlord's intentions *as at the term date of the Sub-lease*, if and insofar as these can be deduced.
17. The point is that (certainly where T has not itself done the remedial works) the essence of the valuation exercise is an assessment of how a hypothetical purchaser for T's interest (carrying with it a liability to L) would adjust its bid in the light of RT's failure to maintain the ground floor in accordance with the terms of the Sub-lease. In other words, it involves an appraisal of T's exposure to L in consequence of RT's shortcomings.
18. This appraisal does not occur in a vacuum. Rather, it is carried out against the backdrop of the actual circumstances which affect the owner of T's interest (whoever that may be). It follows that L's plans for the property may potentially bear heavily on the outcome.
19. Assume, for instance, that it has for several months (prior to 24.12.10) been common knowledge that L wishes to demolish the building and replace it with a brand new development when the Lease falls in. L has publicised its proposals and has obtained planning permission. In that scenario, any purchaser of T's interest would, as regards any dilapidations claim from above, no doubt be mightily comforted by the prospect that section 18 would come to its aid if L should in due course present any claim. That being so, it is quite conceivable that it would be fairly relaxed about the disrepair for which RT was responsible, taking the view that T's exposure to L would not be materially increased in practical terms. Subject therefore to a possible allowance for risk (lest, for instance, L's plans change), it might be that the purchaser would not make a significant adjustment to its bid on that score.

20. Of course, it is possible, even likely, that *as at 24.12.10* (the relevant assessment date) L's plans for the property would not be known or would be considerably less firm and advanced than posited above. In that situation one can foresee that the hypothetical purchaser of T's interest would be considerably more circumspect in its approach and might, depending on quite how conservative its appraisal of the circumstances led it to be, be prepared to take the Lease off T only if in the process allowance for the costs of remedying RT's default were made in full (or, failing that, in very large measure).

#### T's reversion

21. What of the extent of T's reversion? T's Lease encompasses the whole building whereas RT's Sub-lease comprised only one floor thereof. Is T's reversion for section 18 purposes the ground floor alone or is it the entire building?
22. Where the subject premises (at the centre of the dilapidations claim) are part of a larger unit, it is an unresolved issue whether section 18 demands that the valuation exercise proceed on the footing that premises are being sold in isolation from the remainder (even if that would not be lawful in reality, as where the landlord's interest is leasehold and alienation of part only is precluded, or if it would not occur in practice, e.g. where it would result in the creation of a 'flying freehold'). For discussion, see Dowding & Reynolds, *Dilapidations: the modern law and practice*, paragraph 29-28.
23. In many instances it may be that, because the comparison in the valuation exercise requires one to contrast only the value of the premises in repair with that in disrepair (with all other factors being constants), there is no difference



in the end-result – since the other elements in the overall mix will be self-cancelling. However, that will not necessarily always be the case.

24. It is conceivable that the nature of the hypothetical purchaser (and its plans) for the premises – which may well in turn impact on the level of bid and thus influence the diminution in value calculation – may be materially affected by the nature and condition of any other property which is acquired as part of the ‘reversion’, and not only influenced by the condition (good or bad) of the subject premises.
25. In our view, the better construction of the statute requires the whole of the landlord’s reversion to be valued, assuming the premises are in and out of repair. Quite apart from the practical benefits this brings (of avoiding the need to create a notional severed interest in the subject premises alone and then to value an interest for which there are likely to be no comparables), this construction also has the advantage that the landlord is more likely to recover in full for its actual loss. Although section 18 was intended to limit the amounts that landlords could recover, it was not, in our view, intended to prevent them from recovering their actual losses in full – rather it was intended to prevent them from obtaining the windfall of the cost of repairs in circumstances where this went far beyond their actual losses.<sup>3</sup> Accordingly, despite the somewhat infelicitous language (“reversion (whether immediate or not) **in the premises**”), our considered view is that the correct approach is to value the whole of the landlord’s reversion in each case seeking in the process to strip out and isolate the effect of the tenant’s breach of covenant (here, RT’s failure to perform the obligations imposed on it in relation to ground floor by the Sub-lease). However, this starting point may need to be

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<sup>3</sup> In *Latimer v Carney* Arden LJ said @ [39]: “I proceed on the basis that Parliament certainly did not intend that s.18 should render it impossible for a landlord to obtain proper recompense for breaches of the repair covenant without undue expense and delay.”

revisited in any given case if the result throws up apparent injustice to either landlord or tenant.

#### Negative values

26. In terms of positive or negative value, it remains a common misconception that, if the landlord's interest would carry no positive value even if the tenant had done what it should, then the diminution in value must be nil. This is not the case. Subject always to the appropriate valuation evidence, a nil or negative value may be rendered negative or (as the case may be) its negativity increased. That differential, the increased liability (essentially, the (additional) reverse premium which would have to be paid in order to offload the landlord's interest), represents the amount by which the value of the landlord's interest (whether freehold or leasehold) has been diminished by reason of the tenant's breaches. It is recoverable as such: see e.g. *Lloyd's Bank v Lake* [1961] 1 WLR 884; *Shortlands Investment Ltd v Cargill plc* [1995] 1 EGLR 51.

#### *Service charge*

27. A final and separate consideration is that, although T would have been entitled to pass on (by way of service charge) to RT a share of the costs of eradicating any disrepair affecting the structure and exterior of the building at large had it effected the relevant works *during the currency of RT's Sub-lease*, it is now unable to do so. The horse has bolted. The moral is that, if T had wished to benefit from such (relatively assured and uncomplicated) means of recovery, it needed to act in good time. Having left it too late, it must now bear such costs itself.

## **Suggested considerations in relation to Scenario 2**

28. This builds on Scenario 1 and introduces further issues calling for examination.

### *Section 18 – second limb*

29. Can T knock-out L's claim altogether based on the second limb of section 18? It may be logical to consider this first.
30. Whether T can prevail will depend on whether L intended, at the Lease expiry date, to demolish the building then or shortly afterwards .
31. This will hinge on all the facts and evidence. It should be noted that the second limb is engaged only if: (1) the actual landlord (2) had the relevant intention (3) at the relevant date. What follows from this is: (1) it is the actual landlord's state of mind that is key – the issue concerns its subjective intention and thus (unlike the position in relation to the first limb – where damage to the value of the reversion is assessed objectively) the intentions of others count for nothing; (2) the person in question must have had a firm and settled desire with a reasonable prospect of effecting the same; its proposals must have been fairly concrete and clearly more than mere preliminary contemplation at a point when it was still exploring options and feeling its way; (3) the intention at the term date is what matters; if (for instance) the actual landlord entertained no notion of demolition until sometime later, it would not be prevented from recovering damages by the second limb – even if the works happened to commence “shortly after” the end of the lease. Similarly, if the landlord did intend, at the date the lease expired, to demolish the building, but did not intend to do those works until some future date, that again would not fall within the second limb (although it might well bear on the first limb). Conversely, if the landlord had the requisite intention at the

term date, it would be precluded from recovering damages by the second limb even if it changed its mind afterwards.

32. Issue (1) in the preceding paragraph means that the mere fact that a building has a potential for comprehensive redevelopment is irrelevant when it comes to the second limb of section 18 unless (at the relevant time) the actual landlord, cognisant of that potential, has itself the relevant intention, i.e. has put in motion plans to realise such potential: see e.g. *PGF II SA v Royal & Sun Alliance Insurance plc*.

33. A further point is that the second limb applies only where the landlord's proposals would have been formulated "in whatever state of repair" the premises might have been. Consequently, if L (while admitting that it has for quite some time contemplated demolition) establishes that it is so interested (i.e. that it countenances wholesale demolition) only because of the appalling condition in which the premises have been returned to it and that, had the same been delivered in a state commensurate with compliance with the repairing covenants, demolition would not have occurred, the second limb of section 18 would not be engaged.

34. It is also worth considering whether works which commence 6 months after the term date are taking place "shortly after" it – or whether they are too late to qualify for the purposes of the second limb. Although this is again a fact-sensitive question, we consider it likely that a court would consider works commencing 6 months after the expiry date to fall within the definition of "shortly after" the term date.

#### *The new common law?*

35. What if the landlord had not reached a decision to pull the building down at the termination date, but that was, in fact, the only reasonable decision he

could make? According to HHJ Toulmin CMG QC in those circumstances the common law damages will be assessed “on the basis that the landlord has reached that decision” per *PGF* @ [70.6]. What does that mean? Is it the same as the diminution in value measured under the first limb? In our view, the answer to this is probably!

### *Section 18 – first limb*

36. Assuming that the second limb is not in play, it is necessary to consider the first limb, namely the issue of diminution in value of L’s reversion assessed as at 23.6.11, either because it matches the common law measure, or in order to “cap” the common law measure.

### Post valuation date events

37. Obviously, the works undertaken by L postdate the valuation date. Does that mean that they are inevitably of no consequence and are inadmissible? The answer is no.
38. Although not of direct bearing on the quantum of damages, the occurrence of events after the term date often serves to cast light on the value of the reversion at that date: see e.g. *Smiley v Townshend*. These subsequent events, if they relate to the bases of valuation, can be taken into account: *Latimer v Carney*.
39. Although a valuer cannot have regard to matters which could not possibly have been known about, and influenced any bid, on the valuation date, matters such as the steps taken by the actual landlord (in relation to e.g. the redevelopment, refurbishment or sale of the premises after the term date) may nonetheless constitute good evidence of the way in which (viewed objectively) the hypothetical purchaser of the reversion would have

approached matters, and thus constitute evidence of the extent of the damage, if any, to the reversion (i.e. the diminution in value): see e.g. *Firle Investments Ltd v Datapoint International Ltd* [2000] EWHC 105 (TCC).

40. So, in other words, a property's potential for (total or partial) redevelopment (evidenced by the actions of the actual landlord) will – even though not determinative for the purposes of the second limb of section 18 – often be of marked relevance to the valuations in relation to the first limb. As Arden LJ put it in *Latimer v Carney* @ [38]: “*I would ... accept that where the repair works ... will be overtaken by refurbishments which the landlord or a purchaser of the property proposes to do, that indicates that the reversion has a latent development value. The landlord would have to show that the repairs caused damage to the reversion, and this may in the circumstances be difficult. Alternatively he will have to show that the refurbishment would incorporate some of the repairs the former tenant should have carried out, i.e. that specific repairs would “survive” the refurbishment.*” This reflects the fact that there may be supercession of repairs by modernisation works.
41. It will always be a matter for the valuer but in the scenario under consideration it might well be that the conduct of L would be regarded as demonstrative of the redevelopment potential of the property and indicative of how which those in the market for L's reversion at 24.6.11 would have seen matters, leading to the conclusion that the likely hypothetical purchaser (at least of the premises as they were in fact left) would be a developer rather than investor – with consequential valuation ramifications. Of course, if it be the case that L's actions were (for some cogent reasons) wholly unrepresentative of the market, then they will in fact not bear on the market-based test demanded by the first limb of section 18.
42. But, all other things being equal, one would not readily expect the court to ignore what the landlord has actually done.

43. The significance, or potential significance, of the landlord's intentions in measuring loss (in particular, diminution in value of its reversion) is demonstrated by the now formally CPR adopted Dilapidations Protocol (to give it a manageable, rather than its full, title) which requires both landlord (para. 3.6) and tenant (para. 5.5) to confirm that full account has been taken of the landlord's intentions for the property. Further, a landlord which has not carried out all the works must identify which works it intends to carry out and when (para. 9.3). And its Quantified Demand is not supposed to include "items of work that are likely to be superseded by the landlord's intentions for the property" (para. 4.6). The stated intention may affect the inferences which the court may be prepared to draw in relation to the existence and quantum of any diminution in value. That said, the weight to be given to mere expressions of intention will depend on all the evidence at trial and plainly actions speak louder than words.

#### *Loss of rent*

44. What to make of L's loss of rent claim? Suppose that the evidence shows that it would take 6 months (the period necessary for completion of the remedial works) for L to find a new tenant of the building in any event? Does this mean that the loss of rent claim is necessarily eliminated altogether?
45. It is suggested that the answer is not necessarily. At first blush, this may indeed be thought to be the consequence – because after all (to be recoverable at common law) loss of rent must represent the landlord's actual loss, i.e. it must have been able to relet but for the need to remedy the disrepair: see e.g. *Scottish Mutual Assurance Society Ltd v BT plc* (1994). However, that may not always be the whole story. For instance, it may be that the disrepair is so substantial that it precludes any, or the effective, marketing of the premises until it is eradicated – with the consequence that

L's ability to obtain a rental income stream from the property is deferred by that period (over and above the void which market conditions would cause it to suffer irrespective of the disrepair). Since damages are supposed to compensate for the actual loss that has been sustained by reason of T's breach of covenant, in principle L should be entitled to recover accordingly.

46. The interplay between a loss of rent claim and the first limb of section 18 should also be borne in mind. Sometimes those acting for landlords seek to add a loss of rent claim on top of the figure thrown up by the expert's diminution in value calculation. However, we suggest that this is impermissible double-counting: (1) the first limb caps the damages recoverable generally, including loss of rent; (2) as a result, loss of rent is recoverable if but only if it forms part of the damage to the reversion; (3) the section 18 valuation ought to be based on an assessment as to whether (and, if so, by how much) the hypothetical purchaser would discount its bid to reflect a perceived loss of rent associated with the carrying out of the works; (4) if an allowance is made in that context, there is obvious double-recovery if a further end-allowance is applied; (5) if no allowance in that context, it is the result of the operation of the cap.

47. In our view, in any given case depending on all the circumstances loss of rent is either a material factor to be taken into account when valuing the reversion (in which case it will be reflected in the diminution in value) or it is an irrelevance (in which case it has no part to play).

*Timing dependent differences of outcome?*

48. Finally, standing back and comparing the position as between T and RT in scenarios 1 & 2 above, it strikes us that it may well be in RT's interest, if at all possible, to ensure that T's claim against it is not determined until L's claim against T has been dealt with – or, at least, ventilated, explored and dealt with under the Dilapidations Protocol.



49. This is so notwithstanding that, strictly speaking, the two claims are distinct and have separate origins. Although there is no inexorable correlation between them (and it is to be noted that they have different valuation dates), nonetheless what is apparent from the foregoing is that, despite this, there is a close connection and some interplay between the two claims. In particular, the issue of L's intentions for the property may bear on both.
50. Yet in the context of T's claim alone RT may find it difficult to obtain evidence of L's intentions. But if L's claim is also live and on the table (so to speak) rather more comprehensive information and material may be obtainable in practice. Also, the fuller picture may afford RT with a better prospect of resisting T's claim, by pointing to the lines of argument/resistance which it is open to T in turn to deploy against L. By this means RT may perhaps be able to avoid being dealt with wholly in isolation with its attendant risk of a 'mismatch' in terms of outcome (at least from RT's perspective).
51. An example may help to explain. If T's claim against RT is disposed of at a time when there is no evidence of L's plans for demolition of the property, the chances of RT successfully arguing that the damage to T's reversion should be held to be considerably less than the basic cost of works are surely that much lower than would be the case if L's intentions were known. That being so, RT might be ordered to pay damages based on the cost of works, only subsequently to discover that T effectively obtained a windfall because it was able to ward-off much/all of the claim advanced by L.
52. It is right to say that purists would observe that, given the difference in the two valuation dates (24.12.10 & 23.6.11) – which entail that the state of the market, the nature of the likely hypothetical purchaser and its plans for the property could differ between the two dates, there is no reason why the

results of two separate pieces of litigation between different parties should necessarily mirror each other. This is correct in principle. However, in our experience judges are human and, sentiment being what it is, a preference for a symmetrical result (which flows smoothly from top-middle-bottom of the chain of interests) is likely to be preferred if the evidence does not absolutely compel a contrary outcome.

### **Suggested considerations in relation to Scenario 3**

#### *The First Limb*

53. This scenario requires a more in-depth examination of the question raised by Scenario 1, namely as to the extent, nature and condition of the “reversion” to be valued.
54. How should we value the diminution in value in the reversion to RT’s tenancy in this scenario? The options appear to be:
- a. We value the reversion assuming that the upper floors were not there (i.e. did not exist);
  - b. We value the reversion (of the building) as is;
  - c. We value the reversion (of the building) assuming that the upper floors are in good repair.
55. For the reasons already given in relation to Scenario 1 above, it does not seem to us that (a) is right. However, choosing between (b) and (c), even as a start point, is not easy.

#### Approach (b)

56. On the one hand, (b) is attractive because it accords with the presumption of reality, and enables the valuer to value what is actually there without the

need to make any artificial assumptions. It squares with the notion that the “reversion” is “the landlord’s then interest in the premises” or the property “as it has come back into the hands of the landlord”, i.e. as it has reverted to the landlord. The valuation required is thus of the interest that the landlord actually had on the valuation date. This seems to be in line with the stance taken in *Van Dal Footwear Ltd v Ryman Ltd* [2010] 1 WLR 2015, CA @ 8-11] where (albeit in a different context) Lewison LJ observed, “*What the judge embarked upon was a determination of a hypothetical fact. The only hypotheses required or permitted by section 18(1) of the 1927 Act are first, the hypothesis that there are two simultaneous sales of the reversion, and second, the hypothesis that, in relation to one of those sales, the property was in the physical condition required by the repairing covenants. No other hypothetical facts are required or permitted.*”

57. If the consequence is that the total diminution in value of T’s reversion is less than, or greater than, the sum of RT’s liability and OT’s liability (each separately assessed) – as to which see the discussion in paragraphs 59 – 61 below, it can be said that this is simply an incident of the requirement flowing from the statute that the consequences of any individual tenant’s default be determined in isolation – so that liability attaches only for the consequences of that person’s breaches even if that leaves T under- or over-compensated.

#### Approach (c)

58. Approach (c) starts from basic principles of contract law. A dilapidations claim is merely a type of claim for damages for breach of contract. A defendant to such a claim will only be liable for losses which were **caused by** his breach. Put the other way, the landlord can only recover damages for losses where the tenant’s breach was the “effective” or “dominant” cause of

those losses, so, RT cannot be liable for losses which were caused not by him, but by OT's breach. A simple way to strip out all of the diminution in value caused by OT's breach (or anything else which is outside the control of RT) is to assume, when assessing RT's liability, that it had not occurred and to perform the valuations on this basis. However, there are 2 qualifications.

59. First, what if the total diminution in the value of the reversion is *more* than (a) the amount for which RT would be liable, assuming OT's breaches had not been committed; plus (b) the amount for which OT would be liable assuming RT's breaches had not been committed? Is T not able to recover that extra amount from anyone? If this analysis is adopted a possible answer is that, in that scenario, T could sue either RT or OT for that extra amount, since it could fairly be said that both party's breaches were of equal efficacy in causing that loss. (Whichever party was sued by T would have a right to recover a contribution from the other.)
60. Secondly, what if the total diminution in value was *less* than the total of (a) the amount for which RT would be liable, assuming OT's breaches had not been committed; plus (b) the amount for which OT would be liable assuming RT's breaches had not been committed? Does T get to recover in full from both? The true position, it is suggested, is that RT's liability cannot **exceed** the amount which T's interest would have been diminished by as a result of RT's breaches, assuming that OT had not committed any breaches. That will, of course, also be the position in relation to OT's breaches – OT's liability cannot exceed the amount by which T's reversion would have been diminished if RT's breaches had not occurred.
61. So, how should that total loss suffered by T be divided between RT and OT? It is tentatively suggested that, in those circumstances, the right

course would be to pro rate the liability between OT and RT, in proportion to the amounts for which they would have been liable had the other not committed any breaches. A “wrinkle” to that might be where the other party (say OT) is known to be insolvent – in those circumstances, it there may be an argument that RT should then be liable for the full extent of the amount by which its breaches would have diminished the value of the reversion if OT’s breaches had not been committed, because the only reason to depart from that general rule is to avoid the landlord making a double recovery or otherwise being over compensated.

### *The Second Limb*

62. If OT’s breaches are so gross that, as a result of those breaches, L is bound to demolish the whole building when T’s tenancy comes to an end, that may well extinguish RT’s liability altogether – for the second limb is likely to be engaged. It is to be noted that it does not have to be the tenant’s immediate landlord (here T) that intends to pull the building down. Although it will generally be that person whose intention is key, an intention held by some other relevant party (such as a local authority under a demolition order or compulsory purchase powers) will suffice: see e.g. *Salisbury v Gilmore* [1942] 2 KB 38, CA @ 45. In principle, therefore, the intention of a superior landlord may be relevant.
63. Again, however, if L makes the decision to pull the building down because both OT and RT have committed gross breaches, difficult questions of causation will arise. Both OT and RT will seek to argue that, regardless of their own breaches, L would have decided to pull down the building because of the breaches of the other, so they should not be liable for any damages – a sort of ‘divide and rule’ approach with a view to each escaping liability.

Against that, T (who will be liable to L in respect of the disrepair of the whole building – without itself having any viable second limb defence vis-à-vis L – and who will seek to recover as much as possible from RT and OT) will of course seek to argue that if either had left their own premises in good repair, the decision would not have been made, so neither can rely on the second limb.

64. Much depends on the facts – but, if we assume that the facts are that the decision to demolish the building was solely because of OT’s breaches and would have been made even if RT’s breaches had not occurred, then: (a) RT will not be liable for anything, by virtue of the second limb (always assuming that, given the temporal gap between expiry of the sub-lease and the Lease, L’s intention was to demolish the building “at or shortly after the termination” of the sub-lease); whereas conversely (b) OT will be liable for damages.

65. The interesting question is how the damages payable by OT would be measured in that scenario. Would they be:

- a. simply the cost of carrying out the necessary remedial works to OT’s demise (which plainly gives T nothing in relation to RT’s breaches);  
or
- b. the diminution in value to T’s reversion sustained as a result of OT’s breaches?

66. As to the latter, in such special circumstances where OT’s breaches cause L to decide to demolish the premises, and therefore T is precluded from recovering from RT, is OT liable for the whole of the diminution in value arising from the disrepair of the building, and not just the part arising from

the disrepair in OT's demise? To recover damages on that footing would require an expansion of the standard common law measure of damages (cost of works). However, the basic principle is that damages are intended to be compensatory of loss and to meet the justice of any given case and so it is conceivable that the well-established 'rule of thumb' may require adaptation in some situations. Accordingly, it is tentatively suggested that the answer to the question might be yes – although there is considerable scope for debate and argument (not least in relation to issues of remoteness of damage).

67. What is more, that then throws up another potential difficulty: the diminution in value (being the expanded common law measure of damage) might be *greater* than the cost of the works within OT's demise. In a direct landlord-tenants situation, could a tenant of part could argue that the landlord had failed to mitigate its loss by deciding to demolish the premises rather than repair and obtain damages from the tenant of the other part? In that scenario, it might be argued that the tenant's liability could not exceed the lower of (a) the cost of the works within his demise and (b) the diminution in value of the whole of the reversion. If accepted, this would mean that if L decided to demolish the building in this scenario, it would potentially not make a full recovery. However, that analysis does not translate into a landlord-tenant-subtenants situation – for T has no choice as to the steps that L takes, so cannot be said to have failed to mitigate his loss; and L can recover in full from T. In that scenario, there does not appear to be any answer to a claim against OT for the whole of the diminution in value of T's reversion (i.e. OT must indemnify T against the whole of L's claim against him).

## Suggested Considerations in relation to Scenario 4

68. The danger (for L) here is that it will be persuaded not to pursue its existing claim for dilapidations on the basis that this is the only basis on which T will sign up for a new lease. L needs to be aware, if its intent is to “defer” and “roll over” the dilapidations claim, rather than give it up completely, that the limitation period will be 12 years (if the lease is by deed), so if the new lease is to be for a greater period, L will not be able to complain at the end of that lease of breaches of the first lease. L will only be able to complain of breaches of the second lease. That means that it is important that the second lease should either include an express covenant to carry out the works specified in the existing schedule of dilapidations before the termination of the second lease, or an agreement that the premises are deemed to be in the condition, at the commencement of the second lease, that they would have been in had the covenants in the first lease been complied with. Otherwise, there is a risk that (despite the fact that a repairing covenant entails an obligation to put in repair, meaning that the tenant will not be relieved from the (ongoing) duty to remedy specific disrepair existing at the date of the second lease, and although the question whether there is disrepair is answered by comparing the present condition of the premises with its condition at the time of its construction) the tenant may nonetheless be able to argue successfully that the class of tenants likely to occupy the building deteriorated between the date of grants of the first lease and the second lease, thus lowering its responsibilities. This is because the appropriate *standard of repair* required by a repairing covenant – which entails consideration of the age, character and general state and condition of the premises – is to be assessed by reference to the circumstances *at the date on which the particular lease is granted*.



69. However, L is in a strong bargaining position, because T cannot use its willingness to take a new lease to reduce the damages which it is liable to pay at the end of the existing lease: *Van Dal Footwear Ltd v Ryman Ltd*. So L has the upper hand in the bargaining, and ought to be able to get the clause it wants.