

## Real World

Finance and Real Estate News

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### HEADNOTE

## Working together



by **Andrew Hutchinson**

Since our last edition we have seen not only a change of government, but a switch to a different form of government—a coalition. This radical departure from two-party politics reflects a growing trend for collaboration throughout society. Consider these examples in the real estate industry:

- Some of our largest developers are looking for partners to work with them to progress major City developments. This is not only an attempt to manage risk, but also a reflection of the continuing difficulties in accessing debt.
- The increasing use of derivative products is another illustration of co-operation for mutual benefit.
- The growth of structuring enables a number of investors to share in the income and gains from real estate without owning the underlying assets.
- Landlords and tenants, particularly in the retail sector, are working together more than

ever to their common advantage. Landlords are granting concessions to help keep tenants afloat in these difficult times; they are agreeing to accept rent monthly rather than quarterly or are reducing rents in return for tenants agreeing not to exercise break rights.

- Landlords and tenants are also increasingly choosing to co-operate to put in place energy efficiency measures by means of a non-binding memorandum of understanding.

And at Dechert, too, we have developed a sophisticated programme to enable us better to project manage large transactions with the aim of improving efficiency and therefore value for clients.

We all benefit by working together.

This issue of *Real World* includes articles on the problems which can arise when exercising a lease break right, contract clauses which don't mean what they appear to, liability for negligent valuation and a round up of recent planning matters.

I hope you find this edition useful and that opportunities on which we can collaborate present themselves very soon.

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LANDLORD AND TENANT

## When break rights go wrong



by **William Fryzer**

*Exercising a lease break right may seem straightforward, but the process is full of traps for the unwary. Notices specifying the wrong break date or the wrong parties have given rise to much litigation, but there are also*

*many other aspects of the process which can go wrong, as two recent cases show.*

In the first case, *Hotgroup plc v Royal Bank of Scotland plc*, the tenant got the contents of the notice right but failed to serve it correctly. The landlord owned the property as trustee for a unit trust and the lease provided that notices would not be validly served on the landlord unless a copy was also served on the property manager of the unit trust. Nine months' notice was required to exercise the break. The notice was served on the landlord in good time but because the copy was served on the property manager less than nine months before the break date, the court held that the notice had not been validly served.

A similar situation arose in the earlier case of *Claire's Accessories v Kensington High Street Associates LLC*, which concerned a landlord's break notice. There the lease required the notice to be served on the tenant at its registered office address and so a notice served on the tenant at the premises was invalid.

It is important to read the whole of the lease carefully and to comply scrupulously not only with requirements relating

to the break notice but also any general notice provisions.

Even if the notice is drafted and served correctly, it will still not be effective to end the lease if the break right is subject to a condition which is not complied with. In another recent case, *Bordcrest Properties Ltd v Development Planning Partnership LLP*, the break right was conditional on performance of the tenant's covenants. Negotiations about dilapidations had not been settled by the break date and the landlord claimed that the outstanding breaches of the tenant's repairing covenant prevented the break notice from being effective and applied for summary judgment in respect of outstanding rent for the period since the break date. The court accepted the tenant's argument that the negotiations showed that the landlord had accepted that the lease would end on the break date, irrespective of the disrepair, and held that it would be inequitable for the landlord to insist on the condition to prevent the lease ending—in the jargon, the landlord was “estopped” from doing so.

Landlords must be very careful to ensure that negotiations are made on a without prejudice basis to prevent such an estoppel arising.

An earlier case, *Legal & General Assurance Society Ltd v Expeditors International (UK) Ltd*, shows that further problems can arise when negotiations are settled. The tenant paid a lump sum described as being in full and final settlement of the dilapidations claim and lease breaks. When the tenant failed to vacate the premises on the break date, the Court of Appeal held that the effect of the settlement agreement was that the landlord had waived the right to rely on the conditions and the lease would end even if the conditions were not complied with.

In last summer's edition of *Real World*, we explained that once a break notice is given it cannot simply be withdrawn and examined the problems which can arise if the parties continue as if the notice had not been given. It has been suggested that a way around this problem is for the tenant to fail to comply with a condition of the break, such as giving vacant possession. It is thought likely that this would work to prevent the lease from ending. However, if the landlord does not want the tenant to remain, it could waive the benefit of the condition so that the break notice will take effect despite the tenant's continued presence.

Finally, if the notice is valid and any conditions are complied with so the break is effective, but the tenant fails to vacate and the landlord has not agreed that the tenant may stay, the landlord could invoke its right under section 18 of the Distress for Rent Act 1737 to claim double rent for the period that the tenant remains as a trespasser.

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## CONTRACT

**Don't take it literally**by **Jon Bola**

*The words of an agreement cannot always be taken literally. Sometimes, however clear the meaning of a clause may seem to be, a court will decide that it really means something else.*

That was the case in a recent decision of the High Court, where the owner of a shopping centre sued Debenhams for breach of an agreement for lease. Debenhams had agreed to take a lease of a unit in the centre and the landlord was to pay them £425,000 within 10 working days of the date on which they were given access to fit out the unit. The agreement contained a default clause (see box) which, if read literally, appeared to allow either party to end the agreement if the other did not comply with any of its provisions. When the payment was not made on time, Debenhams terminated the agreement and refused to accept the money when the landlord tried to pay it late.

**Default clause**

"If either party shall in any respect fail or neglect to observe or perform any of the provisions of this Agreement or an Event of Insolvency arises then either party may by notice to the defaulting party any time after such occurrence terminate this Agreement, and upon service of such notice this Agreement shall determine"

But Debenhams was wrong to think that the clause meant exactly what it said. The landlord successfully claimed that the clause did not in fact entitle Debenhams to terminate the agreement and that its conduct in purporting to terminate it was a repudiation of the agreement which allowed the landlord to terminate it and claim damages.

The reason for the decision is based on a principle of contract law that failing to comply with a time limit in a contract is not a serious enough breach to entitle the other party to end the agreement, unless the parties intended time to be "of the essence" of the contract. That intention might be shown by wording which expressly says that time is of the essence, or it might be implied by other terms of the agreement. If failing to comply with a time limit would deprive the other party of the benefit of the contract which it was intended that they should receive, then it will generally be presumed that time is intended to be of the essence. For example, if the exercise of a tenant's break right in a lease is linked to the timing of a rent review, then that may show that time limits in



the rent review process must be strictly complied with because otherwise the tenant may be deprived of the benefit of the break right.

The court said that it flouted business common sense to construe the default clause as meaning that the agreement could be terminated if there was any failure to perform any provision, however minor the provision and however insignificant the failure. It said that a reasonable person would understand the clause to mean that it applied only to a repudiatory breach, that is a breach which goes to the heart of the agreement. It decided that time was not of the essence and so the failure to make the payment on time was not a repudiatory breach and did not entitle Debenhams to terminate.

If it is vital that a time limit is complied with, then the parties involved in an agreement should make sure that time is expressly made of the essence, either in the contract itself, or by giving formal notice to the other party to that effect.

**Source:** *Dominion Corporate Trustees Ltd v Debenhams Properties Ltd* [2010] EWHC 1193 (Ch).

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## VALUATION

### It's the end that matters, not the means



by **Gillian Baxter**

*In property valuation the important factor is the valuation figure arrived at, not the methodology used. A valuer will not be liable for negligence if the valuation is within an acceptable margin of error, even if the*

*method used was faulty and the right answer was arrived at by accident!*

That was the conclusion of a recent High Court case concerning the valuation of a property investment consisting of four hotels. It may seem surprising that an apparently incompetent valuer may escape liability in this way simply through luck. However, the outcome is in line with established principles laid down in a number of previous decisions and follows logically from the fact that the buyer relying on the valuation is not concerned with the methodology used and will have suffered no loss if the valuation figure is correct.

However, accepting that valuation is not an exact science, getting the valuation figure "correct" is taken by the courts to mean arriving at a figure which lies within a permissible margin of error or "bracket". The size of that bracket depends on the type of property to be valued.

Valuation is basically a matter of finding the price at which comparable properties have been sold, and, as no two properties are exactly the same in every detail, adjusting those prices, or "comparables", to fit the characteristics of the property to be valued. If the property is ordinary, then similar properties will often come onto the market and there will probably be a great deal of comparable evidence which will not need much adjustment.

The valuation arrived at in such circumstances is likely to be fairly accurate and therefore the acceptable margin of error will be relatively small. The more unusual the property is, the fewer comparables there are likely to be, the more they are likely to need to be adjusted and therefore the less accurate the valuation is likely to be. So the more unusual the property is, the greater the bracket will be.

The judge decided that, as a general principle for a standard residential property, the margin of error may be as low as plus or minus 5 per cent. For a valuation of a "one-off" property, the bracket will usually be plus or minus 10 per cent. And if the property has exceptional features, the margin could be plus or minus 15 per cent, or even higher in an appropriate case.

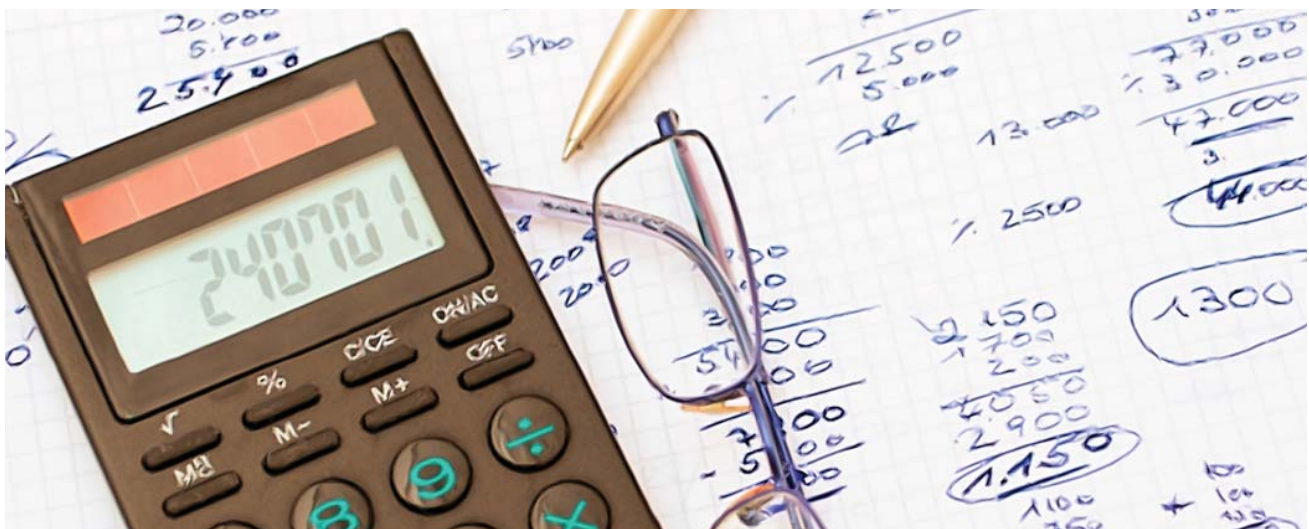
Even if the valuation falls outside the bracket, the valuer might still not have been negligent. It will also be necessary to establish that the valuer failed to exercise the proper degree of care and skill to be expected of a competent valuer.

In the recent case, the valuer failed to take account of a provision in the rent review clauses of the hotel leases which was unusually beneficial to the tenants and ought, therefore, to have resulted in a lower valuation. However, despite that mistake in the methodology, the valuation was less than 10 per cent above the correct level and therefore fell within the bracket, which the judge decided was at least 10 per cent in this case because the properties were unusual. Consequently, the valuer was not liable in negligence.

**Source:** *K/S Lincoln v Richard Ellis CB Hotels Ltd (No 2) [2010] EWHC 1156 (TCC).*

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## PLANNING

## Planning round up



by Justin True

**CPO case: Sainsbury 4, Tesco 3**

By a majority of four to three, the Supreme Court has backed Sainsbury's objection to Wolverhampton City Council's

decision to use its compulsory purchase powers to acquire the outstanding land required for a supermarket development by Tesco.

Sainsbury owns the majority of the site but was not originally interested in developing it and intended to sell its interest to Tesco. Tesco entered into a conditional contract with the Council to acquire a small part of the site which was in Council ownership. The agreement also included an obligation by Tesco to develop a separate site, the Royal Hospital, which would not be economically viable without a cross-subsidy from the main development. Sainsbury then had a change of heart and both supermarket operators were granted outline planning permission to develop the site. The Council then had to decide which of the two competing schemes to support by the use of compulsory purchase powers.

At the heart of the case is the issue whether, when exercising its compulsory purchase powers, a council is entitled to take into account a commitment to secure the development of another site which will bring additional benefits to the area. The Council decided to back the Tesco scheme on the basis that it would result in a significantly greater contribution to the economic, social and environmental well-being of the Council's area. Sainsbury applied for a judicial review, arguing that off-site benefits should not be taken into account unless they are connected to the proposed development.

Sainsbury lost in the High Court and the Court of Appeal but finally succeeded by the narrowest of margins in the Supreme Court. The court decided "there must be a real, rather than a fanciful or remote, connection between the off-site benefits and the development for which the compulsory acquisition is made". A cross-subsidy from the land to be compulsorily acquired to a different site does not satisfy that test.

In light of this decision, the safest course for an acquiring authority is to ignore potential benefits which may accrue as a result of the exercise of compulsory purchase powers, no matter how closely they may appear to be connected with the proposed development, unless they flow directly from the land to be acquired.

**Source:** *Sainsbury's Supermarkets Ltd v Wolverhampton City Council* [2010] UKSC 20.

**The end of regional spatial strategies**

The change of government has brought a fundamental shift of policy away from centrally or regionally imposed targets and priorities towards locally based decision making. A central plank of this approach, to be included in a Decentralisation and Localism Bill, is the abolition of regional spatial strategies—regionally set policies and priorities on matters such as housing supply, the environment, infrastructure and waste, which provide a framework for local planning policies.

So keen is the government to implement this change that it is not waiting for the Bill to be passed. On 27 May, Eric Pickles, Secretary of State for Communities and Local Government, wrote to local planning authorities and the Planning Inspectorate saying that the proposed abolition of regional strategies should be taken into account as a material planning consideration in any decisions they are currently taking.

The letter effectively abolished regional strategies, without allowing local planning authorities time to consider how to deal with the change in their local development documents. The move was criticised for creating a "policy vacuum", likely to cause delay and uncertainty for developers and local residents.

Then on 6 July, the strategies were revoked under the Local Democracy Economic Development and Construction Act 2009 and guidance was issued to local authorities to cover the period until the strategies are abolished. The guidance confirms that local planning authorities should continue to work up their development plan documents and that they are responsible for establishing the right level of local housing provision in their area. Current Planning Policy Statements will continue to apply, except for that relating to regional strategies. Local authorities should work with each other to deal with cross-boundary issues on matters such as the environment and transport.

The government saw regional strategies as unnecessary bureaucracy and a failure. They intend to replace them with powerful incentives to build new homes, with local authorities receiving "direct and substantial benefit" from action to support home building. Whether this will be enough to counter local "nimbyism" remains to be seen.

The Decentralisation and Localism Bill will also abolish the Infrastructure Planning Commission, which will be replaced by a Major Planning Infrastructure Unit. National policy statements are also to be made subject to ratification by Parliament.

### No more “garden grabbing”

The previous government’s policy was that 60 per cent of new housing each year should be built on previously-developed (so-called “brownfield”) land. Private residential gardens have, until now, been regarded as brownfield land for this purpose, which has meant that local planning authorities have felt unable to prevent the loss of gardens for residential development.

In a measure aimed at stopping so-called “garden grabbing”, the new government has amended the definition of previously-developed land to exclude private residential gardens and has also removed the requirement to have regard to the national minimum density for housing of 30 dwellings per hectare, so that councils will be able to encourage the building of more family homes if they consider it appropriate for their area.

Whilst these changes will no doubt help to preserve the environment of established residential neighbourhoods, the risk is that they will lead to increased development pressure on green belt and countryside land or greater shortages of affordable housing.

**Source:** *Planning Policy Statement 3: Housing.*

### Public interest outweighs confidentiality

The Information Tribunal has ruled that a report provided by a developer in confidence to a local planning authority in support of a planning application must be disclosed. It decided that the public interest outweighs the need to maintain confidentiality, even though the Tribunal accepted that disclosing the document would damage

the developer’s economic interests. The key factors in favour of disclosure were the need for public scrutiny of the planning process and the fact that the Council owned a building which was to be part of the development. It is important to be aware, therefore, that there is a risk that any documents submitted in connection with a planning application may end up in the public domain if there is considered to be a public interest in disclosing them, even if they are submitted and accepted by the Authority on the basis that they are confidential.

**Source:** *Bristol City Council v Information Commissioner EA/2010/0012.*

### Confiscation of turnover

The Court of Appeal has upheld a confiscation order under the Proceeds of Crime Act 2002 in respect of the turnover from a park and ride business which was operated in breach of planning control and continued to be operated even after a conviction for failure to comply with enforcement action. The court rejected the argument that the order should apply to the profits of the business rather than its turnover, which was much greater. This was a very bad example of the planning rules being repeatedly flouted but it shows that failure to comply with planning law must be taken seriously and may have very costly consequences.

**Source:** *Basso v R [2010] EWCA Crim 1119.*

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