



QuarterDay

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Ask a question

If you have a question about any of the items in this issue of *QuarterDay* please contact the Editor, Sarah Moore s.moore@nabarro.com

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Valuing dilapidations claims: the court will not invent a hypothetical purchaser

Summary and implications

When the court assesses the damages payable in a terminal dilapidations claim, it will value the "bundle of rights" which the landlord actually had on the valuation date.¹

The decision confirms that, when a dilapidations claim is valued, the following will apply:

- What is to be valued is the landlord's interest in the property at the time the property reverts back to the landlord.
- There are two simultaneous sales of the property – one sale of the property in repair and the other sale of the property in the state of repair in which it was returned to the landlord.
- Any later dealings with the property will not be taken into account. This is the case whether a new lease begins before or after the determination of the lease to be valued and whether or not any such lease is granted to the existing tenant or to a new tenant.
- The rent payable under an unsuccessful bid for a renewal lease by the existing tenant is not relevant in valuing the reversion.

Ryman occupied under a series of tenancies at will

In the Van Dal case, the tenant (Ryman) occupied a property in Ipswich. Ryman was obliged to keep and yield up the premises in repair.

The lease was protected under the Landlord and Tenant Act 1954 ("the Act"). Ryman lost the protection of the Act, but continued to occupy the property under a series of tenancies at will. The repairing obligations under the lease were carried forward into the tenancies at will.

Ryman left the premises in a state of disrepair

The parties were negotiating terms for a new lease to Ryman. However, the negotiations were unsuccessful, despite Ryman making two offers to the landlord for a renewal lease.

Ryman vacated the property in July 2007, leaving it in disrepair.

The trial judge found that the value of the property in repair would have been £1,068,838 and its value in its actual condition was £950,000.

The expert witnesses agreed that, for the property to have been sold in its actual condition in July 2007, when Ryman vacated, it would have been necessary to market it for six months beforehand.

Ryman's arguments

Ryman argued that, during the hypothetical marketing period, it would have made an offer to the hypothetical purchaser in the same terms as the offer it had previously made to the landlord.

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¹Van Dal Footwear Ltd v Ryman Ltd [2009] EWCA Civ 1478

The judge found in favour of Ryman: the hypothetical purchaser did exist

At trial, the judge found that an offer on the terms made by Ryman to the landlord would have been attractive to the hypothetical purchaser. If it had accepted the offer, the hypothetical purchaser would have had the benefit of a blue chip covenant and would not have had a void period.

The facts the judge took into account in making his valuation under section 18(1) were not relevant

The judge decided that Ryman would have repeated its offer and that the hypothetical purchaser would have accepted it.

He said that the purchase of the property, and the grant of the new lease, would have happened at the same time. This would have meant that the hypothetical purchaser would have increased its offer to buy the property by 7.4 per cent. Because of this, the judge increased his valuation of the property in its actual condition to £1,020,300, which reduced the landlord's damages claim to £48,538.

The landlord appealed against this decision.

The Court of Appeal decision: a hypothetical purchaser did not exist

The Court of Appeal rejected Ryman's argument, which was that the property must be assumed to be exposed to the market and that a hypothetical, special purchaser must be found.

Having decided that the hypothetical purchaser did not exist, the Court of Appeal had to decide what hypotheses were allowed under section 18(1) of the Landlord and Tenant Act 1927. The court decided that it could only take into account two hypotheses:

- there are two simultaneous sales of the property;
- the property is in a condition that complies with the tenant's repair obligations in respect of one of the sales.

An agreement for lease cannot be taken into account under section 18(1)

The trial judge was wrong to value the property with the benefit of an agreement for lease with Ryman. In doing so, he mis-identified the property to be valued. The appeal was allowed and the 7.4 per cent uplift on the out of repair value was removed.

Section 18(1) of the Landlord and Tenant Act 1927

Damages for a breach of a covenant or agreement to ... leave or put premises in repair at the termination of a lease ... 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.

Failure to deliver a property in compliance with a special condition can frustrate a sale

Summary and implications

The special conditions in a contract for sale are paramount and must be complied with, failing which the buyer may be entitled to rescind the contract and have the deposit returned.

A recent High Court decision¹ is an example of how a special condition in a contract may exacerbate a title problem which it was intended to avoid.

- The special condition in the sale contract stated that there was no leasehold interest. However, it later emerged that a leasehold interest existed at the time of completion.
- In the contract, the seller had promised vacant possession but, was not in a position to give vacant possession on completion.
- The buyer could rescind the contract and claim his deposit, plus interest.

The sale contract contained a special condition which promised vacant possession

In January 2008, Mr Weir successfully bid at auction for the freehold title to a property in Hertford, paying £40,000 as a deposit.

The general conditions in the sale contract provided that the seller would sell with full title guarantee and that all matters recorded in public registers were to be treated as within the actual knowledge of the buyer.

The special conditions provided that vacant possession would be given on completion. It stated that a leasehold interest noted on the title had been determined by operation of law and that the buyer accepted this position and could not raise any further objection or requisition.

In fact, the leasehold interest remained on the freehold title

Prior to the auction, a bankruptcy petition had been presented against the leaseholder. A notice was entered on the Charges Register of the leasehold title.²

The leaseholder vacated and in August 2006 he offered to surrender his leasehold interest. The freeholder purported to accept the informal surrender. Subsequently, a bankruptcy order was made against the leaseholder, and a restriction was entered against the leasehold title.

When the time came for completion in March 2008, the leasehold interest still appeared on the freehold title, showing the notice and restriction relating to the bankruptcy. The purported informal surrender had been void because only the trustee in bankruptcy had the right to surrender the lease once the bankruptcy petition had been presented. Mr

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¹Weir v Area Estates Ltd [2009] All ER (Dec) 189

²Pursuant to section 86 of the Land Registration Act 2002

Weir refused to complete the sale. He rescinded the contract and issued proceedings to claim the deposit back, plus interest.

Mr Weir argued that he had not been given clear title

Mr Weir applied for summary judgment, arguing he was entitled to rescind the contract as he had not been given clear title. He argued that the notice on the register meant the seller knew about the bankruptcy petition when it accepted the purported surrender, making the surrender ineffective.

The seller said that Mr Weir could not rely on a "technical conveyancing defect"

In May 2008, after the date for completion, the seller negotiated with the trustee in bankruptcy and secured a disclaimer from him. The seller therefore argued that Mr Weir could not rely on what was only a "technical conveyancing defect".

The seller argued that the existence of the leasehold interest was a technical conveyancing defect

The seller also cited the special conditions in his defence, arguing that Mr Weir had knowledge of the leasehold interest and had no right to rescind.

The seller said that he had no obligation to search the public registers for any pending bankruptcy and therefore had no reason to refuse to accept the leaseholder's informal surrender.

The judge's findings: Mr Weir was entitled to rescind

As the seller had not been in a position to offer clear title at the time of completion, Mr Weir was entitled to rescind the contract and recover his deposit with interest.

Despite the fact that the leasehold interest had later come to an end, the judge did not accept that the seller's inability to offer clear title at completion was a "technical conveyancing defect".

Practical implications for sellers

- Informal surrenders can be risky and may affect a subsequent sale.
- In some circumstances, such as the bankruptcy of the leaseholder, an informal surrender can be ineffective, even though both parties may have agreed to it.
- If a landlord is offered an informal surrender, he should deal with it by way of a formal deed and ensure the title is investigated properly and the Land Registry title is updated.
- Special conditions are vital terms of a sale contract and must be used only where they are clear and unambiguous and can be complied with at the time of completion. In this case, the wording of the special condition did not meet these criteria.
- If there is a potential defect in title, such as the existence of a leasehold interest, the sale should be subject to the leasehold interest.

Information surrenders can be risky and landlords need to take legal advice

Damages for loss of business premises: how much can a tenant recover?

Summary and implications

In a recent case,¹ the tenants of a shop lost the right to renew their business tenancy under the Landlord and Tenant Act 1954 (the "Act") because of a mistake by their solicitors.

The court decided that the tenants (the Nahomes) were entitled to damages based on the market value of their fixed assets (the lease and the stock). They could not claim for the profits they might have made during the term of the new lease (if had been renewed).

They could not recover any future profits relating to an internet and mail order business, which they claimed had been damaged by the negligence, as these losses were too remote.

Tenants of business premises should note the following points:

- The court will assess damages with a degree of flexibility.
- If a tenant has lost a capital asset, such as a lease or the benefit of a profitable business which could have been sold, compensation will be based on the value of the asset on the date the damage was suffered.
- A tenant cannot claim for future lost profits, unless the profits were reasonably foreseeable by both parties and the tenant can provide acceptable evidence about the loss.

The Nahomes wanted to renew the lease, but their solicitors served the wrong notice

The facts of the case were fairly straightforward:

- The Nahomes had a lease which was due to expire in December 2001.
- In June 2001 the landlord served a notice under the Act stating that he would not oppose the grant of a new lease.
- The solicitors for the Nahomes served a counter-notice on the landlord which read "the tenant will be prepared to give up possession". In fact, the counter-notice should have said "the tenant will **not** be prepared to give up possession".
- The landlord would not accept an amended counter-notice and the court made a possession order in favour of the landlord.
- The solicitors admitted liability for negligence. The High Court hearing was to consider the assessment of damages.

The Nahomes claimed a catastrophic "£1.8m" loss

At the hearing, the Nahomes claimed that the loss of the premises not only brought to an end their retail business, but was also catastrophic for their burgeoning internet mail order business.

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¹Nahome v Last Cawthra Feather Solicitors [2010] EWHC 76 (Ch)

In addition to the capital value of the lease, they claimed expenses for having to move the business, lost profits from the retail business, substantial lost profits from the future internet business and the cost of re-establishing the business in replacement premises. These claims totalled £1.8m plus interest.

Their former solicitors argued that the Nahomes could not claim for all future profits that the retail business might have made during the term of the new lease, as these losses were too remote.

The judge substantially reduced the amount recoverable

The Judge held that, before the flawed counter-notice was served, the Nahomes had not mentioned to their solicitors either the internet business or the fact that they were dependent on retaining their existing premises.

Therefore, the internet business could not have been in the solicitors' contemplation when they served the counter-notice. These losses were too remote to be recoverable.

The judge was critical of the way in which the Nahomes presented their case

The judge also criticised the Nahomes' witness evidence, disclosure of documents and cross examination.

He felt that they had put forward selective evidence in support of their own case and the substantial projected losses of the internet business. At the same time, they had deliberately withheld evidence which was unhelpful to their case.

Even though the judge had decided that the losses of the internet business were too remote to recover, he also made it clear that the projected losses that had been claimed were "wildly exaggerated".

The Nahomes could not claim for the projected losses by the internet business

The damages awarded by the judge were substantially less than the £1.8m claimed by the Nahomes.

The judge disregarded all the projected losses from the internet business and awarded damages of £43,000 based on the market value of the renewed lease together with some associated costs.

Damages and remoteness

Damages are considered to be too remote to be recovered if they are not "reasonably foreseeable".

What is "reasonably foreseeable" depends on the losses the defendant should reasonably have foreseen to have flowed from the breach. This is judged at the time the contract was formed, not the time of the breach.

Original guarantors: the demise of the repeat guarantee?

Summary and implications

The High Court has ruled¹ that a repeat guarantee provided on an assignment was void and unenforceable, and has questioned the ability of a guarantor to guarantee on outgoing tenant's obligations under an AGA. A repeat guarantee will arise when the guarantor of an existing tenant guarantees the obligations of that tenant's assignee.

Both practitioners and property professionals had debated the issue of repeat guarantees for some time before the Good Harvest judgment. It had been hoped that the first case on repeat guarantees would give clarification which reflects commercial reality and practice.

The court found that the repeat guarantee arrangements in the Good Harvest case fell foul of the anti-avoidance provisions in section 25 of the Landlord and Tenant (Covenants) Act 1995 (the "Act"). As a result, the only guarantees landlords can rely on are those given by the current tenant's guarantor (unless it is a repeat guarantor) and the former tenant. The decision does not affect "old" leases granted before 1 January 1996.

This is a landmark case, which has implications for both landlords and tenants.

Implications for landlords

The implications of this decision are widespread:

- This decision is likely to damage the value of landlords' investments and affect future sales, especially where the tenant is of a weak covenant or is a shell company, and has to pay a high rent or faces a large dilapidations claim.
- Landlords may potentially face claims for reimbursement where repeat guarantors have been called upon.
- On purchases, landlords should review any due diligence to ascertain whether there are any repeat guarantees, and try to renegotiate terms, where possible.
- On new lettings, there are some options for landlords: they could consider insisting that the tenant and guarantor take the lease as joint tenants. This would enable an AGA to be given by both entities on the first assignment, but may cause management difficulties for dealing with lease renewals and break notices. Landlords could also try to restrict intra-group transfers to ensure a parent company guarantor is not released.
- Landlords may be able to argue successfully they are acting reasonably by refusing consent to an assignment where the proposed assignee is

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¹Good Harvest Partnership LLP v Centaur Services Ltd [2010] EWHC 330 (Ch)

This is a landmark judgment with widespread implications

not of sufficient financial standing and little or no security is offered, or by attaching a requirement for a suitable guarantor or other security as a condition to the grant of consent.

Implications for tenants

The decision also creates difficulties for tenants seeking to carry out group reorganisations.

- Tenants whose obligations are guaranteed by a parent company may not be able to dispose of their interests to another group company unless alternative security can be provided.
- This may mean tenants have to provide larger deposits, which would place an unwelcome increased financial burden on tenants in the current economic climate.

The tenant wanted consent to assign: the landlord required a guarantee agreement

In the Good Harvest case, Centaur Services Ltd ("Centaur") was the guarantor of Chiron CS Ltd ("Chiron"), the original tenant under a lease. Good Harvest Partnership LLP ("Good Harvest") was the landlord.

The guarantor refused to pay and the landlord began legal proceedings

In 2004, Chiron sought landlord's consent to assign the lease. The landlord granted consent on condition that Chiron and Centaur entered a guarantee agreement under which they each covenanted to the landlord that the assignee would pay the rent and perform the tenant's covenants in the lease from the date of assignment until the next lawful assignment.

Under the guarantee agreement, Centaur had provided a new guarantee of the assignee's performance of the tenant's covenants under the lease as opposed to guaranteeing Chiron's performance under an AGA.

Following completion of the assignment, Chiron failed to pay the rent. Good Harvest therefore sought to recover these sums from Centaur under the terms of the guarantee agreement. Centaur refused to pay and Good Harvest commenced proceedings against Centaur, and sought summary judgment.

At the hearing of the application for summary judgment, Centaur argued that its guarantee was void by virtue of section 25 of the Act.

Centaur argued that its guarantee was void and refused to pay

The High Court agreed with Centaur. The guarantee agreement frustrated the operation of the Act, as the effect of the agreement was to impose obligations on Centaur equivalent to those from which the Act was designed to secure Centaur's release.

The ability of a guarantor to guarantee an AGA

The judge commented that an arrangement whereby a guarantor guarantees a former tenant's obligations under an AGA is likely to fall foul of section 25 of the Act, despite the argument that such an arrangement is not a guarantee of tenant covenants. However, as this was not in issue in this case, the question remains undecided.

Administration expenses: landlords can recover the costs of a winding up petition

Summary and implications

If an administration order is made and a pending winding-up petition is subsequently dismissed, the costs of that petition are payable as an expense of the administration.¹

Landlords should note the following points:

- This decision will protect a claim for the costs of a winding-up petition, which would otherwise have been irrecoverable.
- Cautious landlords can be more confident in presenting a winding-up petition against their tenants at an early stage.

Capitol Films hired Irish Reel to work on a film

Irish Reel had initially been hired by Capitol Films to work on a film about Mary Queen of Scots, which was to be shot in Ireland. Actress Scarlett Johansson was set to star in the title role.

Irish Reel was hired to scout for locations for the film, but did not receive full payment for its work.

Capitol Films was placed into administration after a lengthy battle

In February 2010 Capitol Films was placed into administration in the High Court in London. Irish Reel appeared at the hearing of the administration petition. In August 2008, a winding-up petition had been presented against Capitol Films and Irish Reel had become the petitioner. The winding-up petition was dismissed at the hearing in February.

Irish Reel wanted to recover the costs it had incurred in bringing the winding-up petition.

Capitol Films argued that costs should be limited

Capitol Films disagreed that Irish Reel were entitled to the costs of the petition. They argued that the recoverable costs were limited to those costs of appearing at the hearing of the administration petition.

The judge had to interpret the phrase "the costs ... of any person whose costs are allowed by the court are payable as an expense of the administration" (2.12 of the Insolvency Rules). The judge decided that Rule 2.12 incorporates:

- the person's costs of appearing at the hearing of an administration application; and
- any costs the person has incurred by way of any other petition which is simultaneously dismissed.

Ask a question

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¹Irish Reel Productions Ltd v Capitol Films Ltd [2010] EWHC 180 (Ch)

A person presenting a winding up petition can now claim those costs as an administration expense

High Court decision: winding-up costs are payable as an expense of the administration

The High Court ordered that Irish Reel's costs of bringing the winding-up petition were payable as an administration expense, because these costs fell within the wording of Rule 2.67(1)(c) as set out in the table below.

Irish Reel also argued that its costs should be paid out of Capitol Films' assets in priority to the administration expenses. However, the court was not persuaded by this argument and did not think there was a good reason to vary the priority in which costs are paid in an administration.

Administration expenses: further good news for landlords

This case is the second recent judgment in which the court has given a boost to landlords.

In another recent High Court decision² the administrator was compelled to pay the rent where he had used the leasehold property for the benefit of the administration. [Click here](#) to read our briefing on the Goldacre case.

The judge in Goldacre said that rent was a "necessary disbursement by the administrator in the course of the administration". Service charge, insurance, utility bills, interest and other sums properly due under a lease will be necessary disbursements if the administrator uses the property. If the administrator is not using or retaining the property, all sums due remain unsecured, as was the case before the Goldacre judgment.

²Goldacre Offices Ltd v Nortel Networks UK Ltd (in administration) [2009] EWHC 3389 (Ch)

2.67 of the Insolvency Rules 1986

- (1) The expenses of the administration are payable in the following order of priority:
- (a) expenses which are incurred by the administrator during the course of performing his functions in the administration of the company;
 - (b) the cost of any security provided by the administrator in accordance with the Insolvency Act 1986 or the Insolvency Rules 1986;
 - (c) where an administration order has been made, the costs of the applicant and any person appearing at the hearing of the application. In addition, in respect of out of court appointments, any costs incurred by the appointer in connection with the making of the appointment and the costs and expenses incurred by any person in giving notice of intention to appoint;
 - (d) the amount payable to a person employed or authorised to assist in the preparation of a statement of affairs or statement of concurrence;
 - (e) any allowance made, by order of the court, towards costs on application for release from the obligation to submit a statement of affairs or statement of concurrence;
 - (f) necessary disbursements by the administrator during the course of the administration;
 - (g) the remuneration of any person employed by the administrator to carry out the services of the company;
 - (h) the agreed salary of the administrator; and
 - (i) corporation tax on chargeable gains accruing on the realisation of any asset of the company.
- (2) The priorities laid down by paragraph (1) of this Rule are subject to the power of the court to make orders under paragraph (3) of this Rule where the assets are insufficient to satisfy the liabilities.
- (3) The court may, in the event of the assets being insufficient to satisfy the liabilities, make an order as to the payment out of the assets of the expenses incurred in the administration in such order of priority as the court thinks just.

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