Property Cases Update – February 2015

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There has been another batch of interesting property cases before the Courts.

1. Correcting defective charge – yet again the Courts have had to consider a defectively drafted charge. This time the deed was intended to charge two titles but only mentioned one. This error was discovered by the Land Registry when the application to register the charge was made. The immediate solution was for the Land Registry to exercise the power of alteration contained in rule 130 LRR 2003. It is not a power which has had much attention. After this decision the number of requests to the Land Registry to consider an exercise of the power may increase. The Land Registry after consulting with the solicitors acting for the charge altered the charge by adding the second title. Inevitably this was disputed by those controlling the charger. The challenge was on two grounds:-

(i) the Land Registry did not have power to alter the charge under rule 130; and

(ii) an alteration subsequent to execution without consent caused the deed to be void in accordance with the rule in Pigot's case (1614).

HHJ Pelling sitting in the Chancery Division of the High Court held in Bank of Scotland plc v Greville Development Company (Midlands) Limited and Others [2014[EWHC 128 (Ch) that the Land Registry did have power to alter the charge by adding the property in the second title and the alteration did not cause the charge to be void. It means that rather than pursue a rectification claim there is an additional course open to a party seeking to correct an error in a deed.

Rule 130 – this power is separate from the power to alter the register. It allows the Land Registry to alter "any application or accompanying document". In this case the charge was the accompanying document. To be able to exercise this power one of two sets of circumstances need to apply. Either the alteration is to correct "a mistake of a clerical or like nature.." or in the case of all other mistakes the applicant and all interested parties request or consent to the alteration. The correction of a clerical mistake does not, therefore, need unanimous consent. In this case the mistake of the chargee's solicitor in failing to include the second property agreed to be charged was characterised as a clerical mistake.

Pigot's case – HHJ Pelling held that the alteration did not cause the charge to become void because the alteration was immaterial and not one which was prejudicial to the chargor as the bank was entitled to rectification.

If faced with an error in a document which needs to be registered it means that as a first step it is worth applying for registration and requesting that the Land Registry exercise the power of alteration under rule 130. Such an alteration is less likely to be challenged now.

2. The operation of the equity of exoneration as between sureties guarantors and mortgagors – once a creditor has enforced a charge, suretyship or guarantee due to the failure of the principal debtor there then arises the issue as to how the final incidence of the paid debt is to be borne as between the sureties, guarantors or mortgagors. This can often arise when a loan is made to a business and security for the loan by way of charge or guarantee is provided by relatives of the owner of the business or the company running the business. If the principal debtor fails and the charge or guarantee is called in who will ultimately bear the loss? Will those providing the security bear the burden equally which is the default position or will one or more be entitled to the equity of exoneration and be able to look to others. The equity of exoneration comprises not just a personal claim to an indemnity but also may also include a proprietary claim such as a charge over a beneficial share in the charged property.

In Day v Shaw [2014] EWHC 36 Morgan J. had on an appeal to consider this issue when a loan was made by a bank to a company for its business. The loan was guaranteed by Mr. Shaw and his daughter. The repayment of the loan and the payment of the monies due under the guarantee were charged on the home of Mr. and Mrs. Shaw. The company failed and the daughter and the father were made bankrupt. The home was sold. After paying off the bank there was a balance left. Was this to be divided equally between Mrs. Shaw and the husband's trustee in bankruptcy or was the wife entitled to recover the amount of her share of the proceeds paid to the Bank?

The husband's trustee in bankruptcy claimed that as the spouses were jointly liable under their covenants given in the charge there should be an equal division. Morgan J rejected this approach. The application of an equity required the Court to look at the circumstances to ascertain what is equitable as between the spouses. The Court will be concerned to ascertain who benefited from the loan. If one co-surety or mortgagor wholly benefits then the other co-sureties or mortgagors will be entitled to an indemnity from that benefiting co-surety or mortgagor and to a charge over the beneficial share in the charged property of that co-surety or mortgagor. Mrs Shaw was held to be entitled to such a charge over her husband's share of the balance of the proceeds of sale of their home. The evidence as to whether the wife has shares in the borrowing company was unclear and so she was treated as not having an interest in that company. This was a crucial point.

When there is an absence of documentation this decision ensures greater protection for relatives who accede to a request to provide security for borrowings for the benefit of another relative. However, notwithstanding this clearly the better course is always to have

the proper documentation prepared so that there is no need for the court to investigate what is the presumed intention of the parties.

3. **Drafting what constitutes an onerous planning condition in a conditional contract** – the effect of condition precedents on sale and purchase contracts has had significant consideration by the Courts. However, until now one aspect of such contracts conditional upon the grant of satisfactory planning permission has not been judicially considered. To trigger such a condition the planning permission must not be subject to onerous or unacceptable conditions. Usually these are defined in a schedule to the conditional contract. It is an important part of the particular draft. The problems that it can throw up are well illustrated in the careful judgment of HHJ Dwight sitting as a judge of the Chancery Division in Rentokil Initial 1927 plc v Goodman Derrick LLP. The facts serve to emphasise that the role of those who draft such contracts is not a happy one at times. This judgment at least serves to emphasise that the drafter is not a guarantor of a problem free sale.

Rentokil wanted to sell a surplus property with potential for residential development. It received a number of bids both unconditional and conditional. Unsurprisingly those bids conditional on the grant of a satisfactory planning permission were higher. Rentokil faced a choice. Should it opt for certainty and a lower price by accepting an unconditional bid or alternatively go for a higher price and the risk that a satisfactory planning permission would not be achieved. As this case highlights that risk is not exclusively focused on whether the planning authority will grant the required planning permission but also whether the buyer will seek to resile from the contract. At first the means to resile will depend on whether or not a planning permission is granted. When the stage has been reached that a planning permission has been granted the means by which the buyer can resile moves on to the nature of the planning conditions and whether they are onerous or unacceptable.

A bid of £4.88 million subject to planning permission was accepted. Then the property market started to fall and there was concern that the buyer faced financial difficulties (para. 99). Planning permission for a residential development was granted subject to a number of conditions as is normal. In detailed negotiations between the authority and the buyer prior to the grant agreement had been reached in principle as to the conditions to be attached (para. 25). The learned judge held at para. 26 as regards the conditions attached to the planning permission that “there were no unusual conditions and no material difference between the suggested conditions and the actual conditions”. This was also the view put forward in the evidence of Rentokil’s experts in the arbitration between Rentokil and the buyer. That being the case why was there a claim against Rentokil’s solicitors who drafted the contract?

The buyer no longer wanted to buy at £4.88 million. To resile from the contract it was claimed on behalf of the buyer that the conditions attached to the planning permission

were unacceptable. To set out all the relevant provisions relating to what constitutes an unacceptable planning condition in that contract and the relevant individual planning conditions will take up too much space. Two examples give a flavour of the dispute

(a) para. 2 of the Schedule provided that a condition will be unacceptable if it has the effect of "limiting the planning permission to a set period of time". There was the usual condition that the development must be "begun before the expiration of three years from the date of the permission." This was claimed to be unacceptable.

(b) para. 11 provided that a condition is unacceptable if the effect "in the reasonable opinion of a reasonable developer delaying commencement of the carrying out or completion of the whole or any part of the Development beyond the date on which such carrying out or completion would have occurred in the absence of such condition." It was argued on behalf of the buyer that this provision operated if any condition caused a delay no matter how minor. Virtually every condition will cause some delay but that is not unexpected.

The dispute between Rentokil and the buyer went to arbitration and settled with the buyer purchasing the property for £2.5 million with each side responsible for their own legal costs which as regards Rentokil amounted to just over £600,000. Rentokil then claimed damages against its solicitors asserting that the solicitors had failed to properly draft or advise on the definition of Unacceptable Planning Conditions. The claim was for the difference between the original price and the price actually paid plus the legal costs. Some interesting points come out of the judgment.

(i) Balancing exercise – the learned judge set out the task to be undertaken when drafting the definition of Unacceptable Planning Conditions (para. 31). He considered that the contract should "achieve a balance between the security which the defendant sought in ensuring that completion would take place and the risk that planning consent might not be granted (and therefore the development would not be possible) or the terms of such planning consent might have prevented the development from taking place or materially affected the commercial viability of the project." This could not happen in a vacuum. It was rightly recognised during the trial that there was a difference between "buyer friendly terms and seller friendly terms in relation to potential planning conditions" (para. 67). In the context of standard terms the judge accepted the point made by the solicitor that these were only the starting point in the process of negotiation between the two solicitors. The judge also found importantly in the context of the negotiations and what could have been achieved in them that the buyer was not prepared to agree conditions more favourable to Rentokil (para. 80).

(ii) Solution to achieve proper balance – the judge stated (para. 31) that "the key to balancing those competing aims was to build in an objective assessment of the reasonableness of planning consent and any conditions which accompanied it." This was the

approach that had been adopted on behalf of Rentokil in those negotiations. The buyer wanted acceptability to be tested by the reasonable opinion of the buyer whilst Rentokil's solicitor wanted it tested by the reasonable opinion of a reasonable developer. He had described the buyer's approach to his clients if adopted as resulting in a virtual option. However, even with a truly objective means of assessment there is no guarantee that the buyer will still not try to resile.

(iii) Construction – Rentokil's case was that the Buyer was able to argue that the conditions were Unacceptable Planning Conditions because of the drafting of the Schedule and the arbitrator might have accepted that construction (para. 28). The judge found that the wording was to be construed in the context that the conditions would be unacceptable if unusual and unexpected and either prevented the developer from taking up the permission or tipped the reasonable developer into regarding the development as being unviable due to the condition. Within that context he considered that the condition imposing the usual three year limitation was not as a matter of literal construction an unacceptable condition. Separately to do so did not make commercial sense. When looking at the operation of the individual definitions the construction adopted by the learned judge was guided by what was sensible and represented the commercial purpose and intent (see, for example, paragraphs 38 and 40).

(iv) Reading of documents – one pointed covered in evidence was whether the drafts were being read by the group legal director. It was claimed not. The judge found that it was improbable that he did not read the drafts attached to letters and that there was nothing to alert the solicitor to the practice of not reading documents (para. 63). He later found that it was reasonable for the solicitor to have expected the draft contract to have been read by the director (para. 92). Those findings finished that point in the claim. However, it leaves open the issue as to what should be the response of a solicitor in a transaction such as this when it is appreciated that documents being sent are not being read. It is not possible to compel the reading of such documents. The only safe course would seem to be to provide a more detailed explanation and to make sure that there is a full formal report before execution. To tell the client that the document should be read and leave it to the client to decide whether or not it is does will not really provide an answer if it is known that the reading not going to happen.

(v) Report – the report to the client did not explain in what circumstances a condition would be unacceptable. The reason given in evidence by the solicitor was that the Schedule represented the best that could be achieved and that the report covered the matters which at the time represented a severe risk of the transaction not completing (para. 92). The judge did not make findings specifically on this but did find that the director looked to planning consultants for advice on the commercial aspects of the transaction and that he and the consultant "had a proper understanding of the true meaning and effect of the Contract and the terms of Schedule 1 by this stage" (para. 95). In the light of this claim

inclusion of a reference to the topic of onerous/unacceptable planning conditions should now be considered together with an explicit mention of the risk of the use to which such provisions can be put by buyers.

Not only did the negligence claim fail but also it was held that the settlement of the arbitration was not reasonable as there was no need to do so (para. 147). With respect this seems to me the wholly correct outcome. It is unfortunate that the likely outcome of the making of this claim and the taking place of the trial is to involve those in drafting such documents in more elaborate reporting not with a view to advising the client but rather so as to head off the making of such claims.

4. Consequences of exercise of break clause – the Courts have recently been investigating the consequences of the early terminations of leases by the exercise of break clauses. Last year Morgan J. implied a term so that the last rent paid in advance prior to the exercise could be apportioned into periods before and after the termination. This decision was set aside by the Court of Appeal in Marks and Spencer v BNP Paribas Securities Services Trust Co. [2014] EWCA Civ 603 so that unless the terms of the lease provide for a repayment in such circumstances the landlord will be able to retain the full amount of the advance rental payment. In that case the result covered not just the rent but also a car parking fee and insurance charge. Arden LJ rejected the contention that there is a general principle that the lessee only pays for what it receives.

However, it was made clear that it did not follow that this outcome also applied to service charges. With service charges the expectation is that the payments should relate to expenditure incurred before the expiry of the lease and unspent monies should result in a repayment of service charge to the lessee as in Brown's Operating System Services v Southwark RDCC [2007] EWCA Civ 164. This particular issue has been raised again in Friends Life Management Services Limited v A & A Express Building Limited [2014] EWHC 1463 (Ch). In that case the lease was terminated by the exercise of a break clause in March 2010 but the service charges paid related to expenditure for works some of which were not carried out until 2011. Morgan J. carried out a meticulous consideration of the terms of the service charge provisions in the lease and their operation in order to determine:-

(i) the financial year by reference to which the service charges were to be calculated – it was the full year and not one shorted by the early termination of the lease;

(ii) the costs to be included in the computation – the costs incurred on the major works in 2010 were included but those for 2011 were to be excluded;

(iii) credit was to be given for the amounts paid in earlier service charge years in anticipation of these works;

(iv) the total amount payable by service charge for the financial year then had to be apportioned by reference to the number of days that the lease ran for in that financial year up to the termination date;

(v) any excess payment found to have been paid by the lessee shall be repaid by the landlord to the lessee.

There is a sharp contrast between the treatment of advance rent payments and service charge payments. In both cases the precise terms of the lease need to be carefully considered.