

PROPERTY REVIEW

Restrictive Covenants - The Need to Act Quickly

The reported case of *Gafford -v- Graham* (The Times 1 May 1998) has shown that if a land owner is to preserve his right to enforce a breach of covenant, he must act quickly to object to the breach and, if necessary, start proceedings immediately. Mr Graham owned a piece of land which was subject to a number of restrictive covenants which prevented the land from being used for any purpose other than as a livery stable and yard for horses and for one residential bungalow. They also prevented him from building without the plans first being approved by the Plaintiff. There were two breaches of the covenants. In 1986 the bungalow was converted into a two storey house and the barn was extended, without consent. Although the Plaintiff objected to the local Planning Authority, he did not try to enforce his restrictive covenant and did not object directly to Mr Graham. In 1988 Mr Graham built an indoor riding school. The Plaintiff objected to the planning application but in 1989 Mr Graham began to use the property as a riding school, and it was at this point that the Plaintiff commenced proceedings for breach of covenant. The Court of Appeal decided that in relation to the first breach the Plaintiff had acquiesced in the breach of covenant by not taking action to enforce it and by allowing Mr Graham to incur costs in building. In relation to this breach he had lost his right to any relief and so could not obtain an injunction or damages. Concerning the other breach "the construction of the riding school and change of use of the land to that purpose" the Plaintiff had objected through his Solicitors very quickly and had threatened proceedings, so the Court of Appeal found there had been no acquiescence. However, correspondence between the parties' Solicitors showed that the Plaintiff had suggested a sum of £100,800.00 in lieu of an injunction to settle the dispute. The Court found that because the Plaintiff had sought damages, rather than an injunction, he had effectively waived his right to now apply for an injunction. In assessing damages the reference point was what would the parties have agreed had they negotiated a release of the covenant at the outset. The Court awarded £25,000.00 as damages in this instance.

The conclusion to be drawn from this case is that one must act with speed to preserve a right to enforce a breach of covenant and that damages should not be sought in settlement of the action if the right to apply for an injunction is to be retained.

A 262 year old sting in the tail!

The Distress for Rent Act 1737 was given the Royal Assent seven years before the Battle of Culloden, but is still capable of giving a tenant a nasty surprise at the end of a lease. S. 18 states that if a tenant gives notice of intention to quit at the end of a lease term, but does not vacate, the landlord is entitled to double rent for the period between expiry of the notice and actually vacating. This will apply even if the notice to quit takes the form of a valid break notice. In *Ballard (Kent) Ltd v Oliver Ashworth (Holdings) Ltd.*, in March 1999 (Court of Appeal) a Tenant served an incorrectly dated break notice, and remained in occupation after expiry. The landlord argued that it was ineffective and that the lease continued, but alternatively that if it was effective he should receive double rent subsequently. It was held that the notice was effective, but that the landlord was not entitled to double rent, as to do so he must (but did not in this case) treat the tenant as an illegal occupier. However a late departing tenant when a break date has passed should beware. If he is held to be an illegal occupier he will have to pay double rent.

Liquidation just to escape a lease?

The recent House of Lords decision in *Christopher Moran Holdings Ltd v Bairstow (Re Park Air Services)* has clarified certain issues where a solvent corporate tenant seeks to get out of over rented premises by putting itself into voluntary liquidation. Park Air Services Plc had a 25 year lease with upward only rent reviews at a current rent which was five times higher than market

levels. The tenant placed itself into a member's voluntary liquidation and the liquidator disclaimed the lease. The landlord was entitled to claim for loss of rent in the liquidation, and did so in this case. But how much rent could he claim for and should any sum received be discounted? The first instance decision was that the landlord was entitled to claim for loss of rent for the residue of the term but that this sum should be discounted to reflect accelerated receipt. This has now been held to be correct by the House of Lords, and the discount meant a substantial saving for the tenant in liquidation. Notwithstanding this saving, the escape route of liquidating a solvent tenant company must be seen as a last resort, involving costly reorganisation, and a hefty "surrender premium" by way of compensation.

VAT on Deposits - A Reminder and Recent Case Developments

It is important to remember that if a property is subject to VAT, a deposit paid to the Vendor's Solicitor as agent and not stakeholder for the Vendor will constitute a supply for VAT purposes. However, VAT will not become payable on a deposit paid to a Solicitor who is acting as a stakeholder until the money is actually released to the Vendor. Equally, where the contract is rescinded or otherwise brought to an end, no part of the intent to supply will be made, and any tax accounted for on a deposit can be adjusted, whether or not the deposit is refunded.

On the same issue, the recent case of Higher Education Statistics Agency -v- Customs & Excise Commissioners has created a great deal of uncertainty about the relevant time at which to notify Customs & Excise of an election by a Purchaser to treat a transaction as a Transfer of a Going Concern (TOGC) for VAT purposes. The case concerned the successful bid by HESA to purchase a property at auction for which a deposit was paid to a third party as agent for the Vendor and a contract entered into on the day of the auction. The Tribunal held that the deposit paid did give rise to a supply for VAT purposes as it was not paid to a third party as stakeholder but as agent for the Vendor. It now seems reasonable to conclude from the case that a Purchaser must notify Customs & Excise of an election before exchange of contracts (i.e., before the deposit is paid) where the deposit is to be paid to a third party as agent for the Vendor. On enquiry, it appears that Customs & Excise's current policy remains unchanged, Notice 700/9 states, "the election to waive exemption by the Purchaser ... must be notified to Customs before the time of supply and must apply from that time. "Time of supply" for VAT purposes includes receipt of a deposit which may otherwise have created a tax point."

Therefore, a deposit paid to a third party as stakeholder will not be regarded as a supply and so, in line with usual practice, notification should be received by Customs & Excise before completion of the transaction.

However, confusion still remains as the Tribunal went on to conclude that an equitable interest in the property had also been granted to the Vendor on the day of the auction. If this means that the test for deciding the relevant date on which to notify Customs & Excise of an election is now when any interest in the land is granted to the Purchaser, then the option to tax should be made and notified to Customs & Excise no later than exchange of contracts.

The case is currently on appeal and any change in Customs & Excise policy will depend on the final outcome. At present, Customs & Excise advice is to rely on the wording of Notice 700/9 and opt for tax before exchange of contracts only when a supply is made for tax purposes by the payment of a deposit to a third party as agent for the Vendor.

The Right of First Refusal The Landlord & Tenant Act 1987 - Circumvention

By virtue of s.5 of the Landlord & Tenant Act 1987 a landlord who proposes to sell the freehold (or grant a long headlease) of a building which contains two or more flats held by "qualifying tenants",

where the number of flats held by those qualifying tenants exceeds 50% of the total number of flats in the building, must give the tenants the right of first refusal to buy the freehold themselves. The tenants have two months in which to take up the offer. Landlords should be particularly wary of this requirement following the changes introduced by the Housing Act 1996 which now makes it a criminal offence for a landlord, including a director of a landlord company, to make such a disposal of the freehold without giving the tenants the right of first refusal. The requirements of the Act will be of significance to property developers who, having acquired and developed the property into residential flats for sale on long leases, wish to sell the ground rents to a third party for a premium.

There are two possible schemes under which a landlord may be able to circumvent the requirement of s.5 in these circumstances. The first scheme involves the new development being held by a separate company whose only asset is the property. Once the development is completed and all the flats are sold on long leases, the shares in that company can then be sold to a third party with the value of the shares matching the value of the ground rents. The freehold has effectively changed hands but the identity of the landlord has remained the same.

The second scheme involves an option or contract to buy the freehold which can be entered into before the Act applies i.e. before there are any "qualifying tenants" e.g. before building work on site has finished. Completion of a disposal pursuant to such a contract or option will not amount to a "relevant disposal" for the purposes of the Act and there will therefore be no need to serve a s.5 Notice giving the tenants the right of first refusal.

A Tenancy or a Licence?

Recent developments may now mean that distinguishing between a tenancy or a licence is no longer clear cut. *Street -v- Mountford* ([1985] AC 825, 826) laid down a three stranded test to establish the existence of a tenancy, as opposed to a licence which may be revoked at any time. These were (1) the grant of occupation for a term (2) the payment of rent, and (3) exclusive possession for the occupier.

In the recent case of *Mehta -v- Royal Bank of Scotland plc & Others* the High Court distinguished *Street -v- Mountford* by pointing out that the three principles mentioned above were facts of overriding importance in the particular circumstances of that case, and not necessarily decisive in a case where there were other factors of equal relevance and significance. The facts were that RBS was the mortgagee in possession of an hotel which a receiver managed on its behalf. Managing Agents instructed by the receiver entered into an oral agreement with Mehta giving him exclusive possession on a long term basis of a room in the hotel in return for a monthly rent. After six months Mehta was told to leave the next day as completion was due to take place on the sale of the hotel. He refused, but on returning to his room found that he had been evicted. The Court found that Mehta had a contractual licence, not a tenancy. They looked at all of the factors of the case including the fact that both parties knew a receiver had been appointed and that the hotel would, if possible, be sold as a going concern and that clearly the arrangements were not ordinary for a hotel room.

It was held that, under Mehta's licence, a four month notice period was appropriate. The Court awarded £100,000.00 for unlawful eviction by the receiver and for trespass by the Managing Agents. The Court also held that the receiver was vicariously liable for the trespass by the Managing Agents.

The conclusion of this case appears to be that there is no simple all-embracing test to distinguish between a licence and a tenancy and the Court must weigh up all of the facts in each case to decide what the agreement amounts to.

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further information:

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