Dilapidations—Landlord's Costs and Fees

By

Keith I. Firn, Patrick Stell and Michael R. Watson

Reprinted from **Landlord & Tenant Review**
Issue 3, 2011

Sweet & Maxwell
100 Avenue Road
Swiss Cottage
London
NW3 3PF
(Law Publishers)

SWEET & MAXWELL

Dilapidations—Landlord's Costs and Fees

Keith I. Firn
B.Sc (Hons), MRICS, MFPWS, Director, Datum Building Consultancy Ltd

Patrick Stell
MSc, MRICS, Chartered Building Surveyor, Solicitor (non-practising), GKS Building Consultants

Michael R. Watson, TD
Partner, Property Litigation and Risk Management, Shulmans LLP

Business tenancies; Counter–notices; Dilapidations; Expenses; Fees; Landlords' rights; Repair covenants; Section 146 notices

Most commercial leases include provisions for the landlord to take various actions against the tenant during the term of the lease when wants of repair and other breaches of the tenant's covenants are discovered. Whilst the remedying of the breach, once identified, may be of primary importance to the landlord, the secondary issue of recovery of the professional fees and costs they incur is also likely to be high on their agenda. In this regard, virtually all modern leases contain specific provisions requiring the tenant to pay the landlord's costs of various enforcement actions which will usually include the cost of preparing and serving a schedule of dilapidations.

In many cases, the provision in relation to costs will go further than simply addressing the costs of preparation and service of a schedule of dilapidations and may, for example, provide something along the following lines:

> "The Tenant shall pay to the Landlord, on demand, and on an indemnity basis, the fees, costs and expenses charged, incurred or payable by the Landlord, and its advisors or bailiffs in connection with any steps taken in or in contemplation of, or in relation to, any proceedings under section 146 or 147 of the Law of Property Act 1925 or the Leasehold Property (Repairs) Act 1938, including the preparation and service of all notices, and even if forfeiture is avoided (unless it is avoided by relief granted by the court)."

One such clause led to the judgment in *Agricullo Ltd v Yorkshire Housing Ltd* [2010] EWCA Civ 229 in which the Court of Appeal was called upon to address the recoverability of professional fees by a landlord taking action to remedy wants of repair on the part of a tenant.

There may have been many factors at play which influenced the strategy ultimately adopted in the *Agricullo* case, but the fees which the landlord sought to recover were significant and the case, therefore, highlights the importance of considering the issue of recoverability of fees and costs at the early stages of any action when formulating a strategy to address breaches of covenant by tenants.

The Agricullo case

The lease in this case included the clause set out above [cl.9.3] and also incorporated a covenant on the part of the tenant to keep the premises in good and substantial repair and condition. The lease was for a term of 29 years from November 5, 2001 and it was not long after the grant of the lease that the parties became engaged in a dispute as to the condition of the property.

In February 2003, the landlord served a notice pursuant to s.146 of the Law of Property Act 1925 upon their tenant ostensibly as a precursor to seeking forfeiture of the lease. Attached to the notice was the requisite schedule of dilapidations and also the statutory notice advising the tenant that it was entitled to claim the benefit of the Leasehold Property (Repairs) Act 1938. The tenant subsequently served a counter-notice notice claiming the benefit of the 1938 Act.

After the service of the counter-notice, meetings took place to attempt to agree what needed to be done. Complications arose in relation to planning issues and listed building consent and there were disagreements about the specification of the necessary works and how they were to be supervised. After a period of some delay, the tenant commenced the repair works in March 2005 and they were concluded in July 2005. In May of the following year, the landlord issued proceedings for the sum of £30,000 comprising a number of heads of claim which included solicitors' and surveyors' costs.

When the matter came before the Court of Appeal, the main issue for consideration was the construction of cl.9.3 in relation to the costs incurred after the service of the counter-notice (i.e. incurred by the landlord from the date of service of the counter-notice until the works were completed in July 2005). Most of these were solicitors' and surveyors' costs. The argument advanced by the tenant was that, once the counter-notice had been served, no further steps could be taken by the landlord either to forfeit the lease or to claim damages without first actually seeking the leave of the court. In the absence of such leave (or application for leave), there never were (nor could there be) any "proceedings" in place either under s.146 or under the 1938 Act to which the costs or charges could relate in the context of cl.9.3. For H.H.J. Langan QC, at first instance, the issue was not an easy one to decide:

> "I confess to having found these arguments to be finely balanced. At the end of the day, with some hesitation, I prefer the construction placed on clause 9.3 by the Defendant. The key, in my judgment, is that service of a counter-notice did not necessarily deprive the Claimant for all time of any costs which it might incur thereafter. If the Claimant had applied for and obtained leave to bring proceedings for forfeiture and/or damages, then costs incurred in those proceedings would undoubtedly have fallen within clause 9.3. So too, I think, would the so-called interim costs incurred between the date of the counter-notice and the application for leave. But where, as here, a landlord decides to pursue methods of securing compliance with the repairing obligations of a tenant by means other than proceedings for forfeiture or damages, the costs of adopting that method are simply outside the words of clause 9.3."

The works of repair were, of course, eventually undertaken by the tenant and, therefore, one might expect that a landlord who had successfully identified breaches of the tenant's repairing obligation and ultimately succeeded in requiring the tenant to undertake those works should reasonably expect to recover their costs of so doing—but in this case, they did not.

Essentially, the costs in issue were those incurred as a consequence of the landlord choosing not to initiate proceedings but in pursuing the tenant instead in correspondence and via negotiations so as to persuade them to undertake the works and then in engaging surveyors to supervise and report on the works undertaken by the tenant. Whilst this landlord action was

apparently successful, in that the works were undertaken by the tenant at their direct expense, the lease did not contain suitable provisions allowing the landlord to recover their costs for adopting such a course of action.

On appeal, the Court of Appeal noted that there had been a number of alternative enforcement options available to the landlord, such as the service of a *Jervis v Harris* repair notice or the issuing of court proceedings. Instead of taking any of these options, the landlord opted to deal with the issue by "negotiation" which took the steps taken outside the ambit of cl.9.3 of the lease. Accordingly, the Court of Appeal held that the judge at first instance had been correct in not allowing recovery of the landlord's post counter-notice costs.

The Court noted that, if the clause had been drafted differently, it would have been quite possible that the costs would be recoverable. Referring to the lease considered in *Riverside Property Investments Ltd v Blackhawk Automotive* [2004] EWHC 3052 (TCC), Patten L.J. observed:

> "Had that form of covenant been adopted, these problems of construction would have been avoided. But we have to construe the clause as written and, in my judgment, the qualifying steps have to be linked in a real way to forfeiture proceedings in the sense described in s.146."

So what does this mean in practical terms for the pursuit of dilapidations claims?

Lessons to be learned?

Dilapidations claims are probably unique in the field of litigation in that they are the only category of claim where the initial conduct of the claim is handled principally by non-lawyer professional advisers (i.e., surveyors). Typically in dilapidations claims it will be the surveyor alone who will provide the advice on the pre-action conduct of the dispute i.e. prior to the commencement of court proceedings, Accordingly, not only must the surveyor be considering the lease from the perspective of the repairing obligations (applying the principles relating to breach of contract and the relevant case law) but also they should be looking at the broader strategy for achieving the landlord's objectives whilst at the same time safeguarding their client's interests for recovering the costs of so doing if at all possible. In short the surveyor who takes on this role of advising in relation to breach of contract should have regard to the broader issues relating to the conduct of the [potential] litigation and make sure their client is advised appropriately in relation to all aspects of the matter. This may well include matters such as advice on the making of appropriate offers pursuant to Part 36 of the Civil Procedure Rules and the costs consequences thereof.

We do not know what discussions took place between the landlord and their advisers in relation to the recovery of costs in the *Agricullo* case, but the fact that the landlord was prepared to take the matter to the Court of Appeal might suggest that the recovery of professional costs was important. It is not possible to draw conclusions from the *Agricullo* case as to the extent to which surveyors conducting the initial stages of litigation consider the basis upon which costs may legitimately be recovered but the experience of the authors suggests that surveyors do not always focus on the legal basis for the recoverability of landlord's costs. This is typically evidenced by the inclusion within schedules of dilapidations of substantial sums for "negotiation" often where there is no legitimate basis whatsoever for such a claim. Sometimes landlord's surveyors even claim percentage based "negotiation" fees within the schedule thereby representing these to be properly recoverable as damages for breach of contract.

In practice many dilapidations claims are resolved directly by surveyors based on "commercially pragmatic" terms without legal advice being taken from solicitors and without them coming anywhere near court action.

In such instances the legal basis upon which professional fees might be recoverable may be of little relevance to surveyors. This, therefore, raises the question as to whether or not there is any real need for surveyors to properly consider the issue of legitimate recovery of costs at the outset of a dilapidations matter—whether preparing or responding to a schedule.

Arguably there is a reason to focus on costs, because as the court pointed out in the *Agricullo* case, had the landlord adopted a different approach to pursuing the matter than the one they adopted, then they would have been entitled to recover their costs. As any dilapidations case has the potential to proceed to court, an aggrieved landlord at the start of a dilapidations action (when the schedule is prepared in accordance with relevant professional guidance and protocols) may feel more comfortable in pursuing a claim for breach of contract if they are satisfied that the question of costs recovery has been addressed from the very beginning. If surveyors are to conduct the initial phases of such litigation before the solicitors become involved then, in addition to advising their client regarding the condition of the fabric of the building, we would suggest that they should be studying the details of the lease in relation to costs and factoring this in to the advice on strategy that they provide to their client. This, of course, applies not only in relation to situations where the landlord wants the work undertaken during the term, but also in relation to dilapidations as the end of the lease approaches. We would suggest also that this is equally important (if not more so) for tenants' surveyors responding to claims who should also be alert to instances of claims for costs which have no basis in law.

The law is stated as at April 11, 2011.