Real Estate
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CLYDE&CO

Real Estate bulletin

Welcome to the Summer edition of Clyde & Co's Real Estate Bulletin prepared by members of our real estate and property litigation team. Our bulletins are aimed at keeping you up to speed with recent key developments in the real estate practice area.

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Emails may create a binding property contract

It is surprising to many property professionals that there is no longer a requirement for an inked signature in order to create a binding contract. This is more surprising again where the contract relates to an interest in land.

A contract for the sale of land must satisfy Section 2 of the Law of Property (Miscellaneous Provisions) Act 1989 (the 1989 Act). The purpose of the 1989 Act was to produce certainty in relation to contracts for the sale of land and reduce the need for extrinsic evidence to establish the terms of the contract. Section 2 of the 1989 Act provides that the contract must:

- Be in writing
- Be signed by or on behalf of both parties
- Incorporate all the terms the parties have agreed in one document (or, where contracts are exchanged, in each document)

In *Green v Island [2011] EWHC 1305 (ch)* two sisters had exchanged emails following an oral agreement that a company would borrow £300,000. Emails were later exchanged confirming the arrangements and each sister added her name electronically at the end of each email. In one of the emails one of the sisters confirmed that her company would grant the other sister a charge over its property in exchange for the loan. Subsequently, the liquidator argued that this confirmation was not binding because Section 2 of the 1989 Act had not been satisfied because the emails did not contain all the terms which were orally agreed and there was no enforceable obligation against the company to grant the legal charge over its property. However, the Court accepted that the string of emails satisfied the requirements that the contract be in writing and be signed by the parties. The string of emails constituted a single document signed by both parties. The Judge commented that it was "*the electronic equivalent of a hardcopy letter signed by the sender being itself signed by the addressee*". However, the Court found the contract did not incorporate all the terms agreed between the parties and so the third limb of Section 2 of the 1989 Act was not satisfied.

Nevertheless, lessons must be learnt in that adding the words "subject to contract" or "subject to lease" in communications (including all electronic communications) remains prudent to avoid inadvertently creating a binding contract and in land transactions finding that the parties have bound themselves and satisfied Section 2 of the 1989 Act. This is especially so in relation to heads of terms. It is also wise for emails in relation to land transactions to state that any contract will only be formed by the signature and exchange of a separate document intended to form the contract. Property professionals should observe these rules and remember that their correspondence can bind their principals. They should also avoid long "strings" of emails to prevent these being classed unintentionally as a single document.

Some perhaps surprising recent cases involving electronic communications are also worthy of mention:

- An exchange of emails where a vendor gave a confirmation as to a "sole agency" created a binding contract which meant the vendor was later held liable to pay that estate agent commission as well as another estate agent who sold the property: *Nicholas Prestige Homes v Neal [2010] EWCA Civ 1552 Court of Appeal*
- A signature by a client on a fax quotation which was then returned to the contractor as an email attachment created a binding contract even though the contractor who later took advantage of the signature to successfully claim a binding contract had previously stated that a formal contract would follow. In this case the email correspondence was sufficient to form a binding contract. *Immingham Storage Company Limited v Clear Plc [2011] EWCA Civ 89*

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Endeavours clauses: If at first you don't succeed... then what?

The answer to this question really depends on the type of endeavours clause that you have signed up to. Obligations to use *"reasonable endeavours"*, *"best endeavours"*, or *"all reasonable endeavours"* are littered throughout contracts and require one party to take measures to achieve something.

Although this legal shorthand is intended to dilute an absolute obligation, frequently it serves to introduce uncertainty since it is not always clear what needs to be done and, importantly, when effort can lawfully cease. If you are the one who is subject to the endeavours clause, it can require you to exercise a number of options to achieve an objective, it demands pro-activity, it can require significant expenditure and it can even require you to take legal action against a third party. Furthermore, since the obligation often bites hardest long after the contract has been filed away and the lawyers have gone home, endeavours clauses are fertile grounds for dispute.

A raft of recent case law on the matter has only sought to enforce this state of confusion which may leave you exposed to fulfilling obligations which you were not expecting.

The starting point is what the contract says. The Court construes the contract by reference to the intention of the parties, which is elucidated by the terms of the agreement. Those terms are considered in their commercial context. This impacts on the requirements of an endeavours clause in the same way as any other contract term. Since the facts of each case are different then so can be the lengths that each endeavours clause can require. This accounts for the raft of case law on such apparently well worn legal phrases.

Best/All/Reasonable endeavours

"Best endeavours" is often regarded as being at the most onerous of the endeavours clauses and should not be conceded without considerable thought. It means (helpfully) *"not second best"* and refers to what a *"prudent, determined and reasonable person, acting in its own interests"* would be prepared to do. Although it has been thought the case that *"best endeavours"* clauses are slightly more onerous than *"all reasonable endeavours"* clauses, recent case law has treated the terms as interchangeable.

How many attempts are required to be made to satisfy the best endeavours clause? The case of *Rhodia International Holdings Ltd v Huntsman International LLC [2007] 1 CLC 59* provides the most concise guidance on this point for both best endeavours and all reasonable endeavours. In this case, Flaux J determined that one of the differences between best endeavours and reasonable endeavours is the number of endeavours expected of the obligor:

> "This is because there may be a number of reasonable courses which could be taken in a given situation to achieve a particular aim. An obligation to use reasonable endeavours to achieve the aim probably requires a party to take one reasonable course, not all of them, whereas an obligation to use best endeavours probably requires a party to take all the reasonable courses he can..."

In *AP Stephen v Scottish Boatowners Mutual Insurance Association (The Talisman)* Lord Glennie reached a similar conclusion. He thought that *"the party on whom the obligation is placed will be expected to explore all avenues reasonably open to him, and to explore them all to the extent reasonable"*.

It is clear, therefore, that where the quality of the endeavours required to achieve an objective is greater than reasonable endeavours, multiple efforts (at least) are required. Conversely, where the contract requires reasonable endeavours only then one sensible effort will most likely discharge the obligation.

What about my own commercial interests?

Recently the Court of Appeal has considered the extent to which an obligation to use best endeavours requires a sacrifice of commercial interests. In *Jet2.com v Blackpool Airport Limited* Jet2 (the low-cost airline) and BAL held a joint obligation to one another to *"use their best endeavours to promote JET2.com's low cost services"* and a unilateral obligation upon BAL to *"use all reasonable endeavours to provide a cost base that will facilitate JET2.com's low cost pricing"*. It was common ground that best endeavours and all reasonable endeavours meant the same thing.

The question was whether, in using endeavours to promote Jet2, BAL was required, unprofitably, to accept flights outside of normal operating hours. BAL did not consider itself bound to do so since that involved committing itself to a loss making activity and it did not accept that its obligation to use all reasonable endeavours went that far. The Court held, by a majority, that in making that judgment it was necessary to consider the nature and terms of the contract. The contract concerned flights by a

low-cost carrier. Frequently such airlines need to operate early in the morning and late at night to make money. Consequently the Court accepted that the contract did not allow BAL to refuse flights beyond either end of the day merely because BAL incurred a loss in keeping the airport open for longer. BAL had agreed to undertake all reasonable endeavours to facilitate a low cost base. This meant that, taking into account Jet2's business of low-cost air services, the airport had to stay open beyond usual hours. If that conflicted with the airport's commercial interests then so be it.

However, on different drafting the result is sometimes different. In *CPC Group Limited v Qatari Diar Real Estate Investment Company [2010] EWHC 1535*, the obligation to use *"all reasonable endeavours"* to obtain planning permission did not require the obligor to sacrifice his own commercial interests. In this instance, the *"all reasonable endeavours clause"* was caveated by the expression *"but commercially prudent"* to indicate the level of endeavour which was expected from the obligor at the time of the contract. The Court found that this was enough for the obligor to take into account its own commercial interests in fulfilling its obligations.

This sounds like a nightmare. Is there an alternative?

Endeavours clauses have their place where it is not clear in advance what needs to be done to achieve an objective or where there is more than one legitimate approach. Their weakness lies, however, in their generalisation. It is not always clear what needs to be done and it can be far from obvious where the boundaries of the contractual landscape lie.

The best way to promote contractual certainty is by specificity. Instead of a clause that requires generalised "endeavours", consider whether it is possible to set out in detail the steps that will need to be taken. If the contract contains such a "shopping list" then the parties will know where they stand. If that is not possible or desirable then an endeavours clause will, given its general terms, cover a multitude of eventualities. In those circumstances it is very important that you: (1) go into it with your eyes open; (2) in taking steps to achieve your objective always keep an eye on whether it could be achieved more easily another way; and (3) keep the lawyers on speed-dial. You may well be making a call if matters do not progress smoothly.

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A Cautionary Tale of Two Breaks

Two cases have already been published this year dealing with the issue of a tenant's compliance with conditions to a break. Both cases serve as a reminder to landlords, tenants and their advisers that the rules governing conditional break clauses can sometimes have harsh consequences for tenants.

Tenants and tenants' advisers should take particular care in negotiating the wording of break conditions and landlords and landlords' advisers should be live to issues surrounding the exercise of conditional breaks, especially where property might be difficult to re-let. In particular:

- If a lease requires that all sums due under the lease must be paid in order for the break to be effective, the break will not be validly exercised if any sum (no matter how small) is overdue, even where it has not been demanded by the landlord (unless the lease specifically requires only sums demanded must be paid in order to satisfy the break conditions)
- Professional advisers must take extreme care with the wording of break clauses – both when negotiating the lease and advising a tenant as to compliance (or advising a landlord whether their tenant has correctly exercised a break)
- Where a break date falls between two quarter days and payment of all rent due to the break date is a pre-condition to a break, the full quarter's rent must be paid. There is no guarantee that the tenant will be able to seek a return of a proportion of these sums if the break is validly exercised, so when drafting leases advisers should ensure, where possible, that fixed break dates fall on the days before quarter days
- When faced with a conditional break tenants should ask the landlord to confirm what sums are outstanding in advance of the break date. If the landlord does not provide this information it is important for a tenant to write to the landlord confirming that it is their belief that all outstanding sums have been paid. Landlords should avoid assisting the tenant in complying with their break obligations, but should be aware that, if a landlord knows a tenant is mistaken about outstanding sums and takes advantage of this by not correcting the mistake, a tenant can rely on a landlord's silence as a representation that no sums are outstanding under the lease

Avocet Industrial Estates LLP v Merol Limited and another [2011] EWCH 3422 (Ch) (Avocet)

A question of interest

In *Avocet*, the Court held that a tenant had failed to exercise their break because they had not paid default interest due under the terms of the lease. In this case:

1. The lease provided that the tenant could break the lease on a fixed break date, subject to several conditions (including a break payment of six months' rent payable by the break date). The lease provided that the break would be ineffective if, at the break date, **any** payment under the lease due to have been paid on or before that date had not been paid.
2. The tenant served a break notice, giving requisite notice under the terms of the lease and stating that they were not aware of any breaches of the terms of the lease.
3. Between the break notice being served and the break date the tenant paid the rent late on three occasions but the landlord did not demand any default interest.
4. When proceedings were subsequently brought to determine the validity of the break, the Court found that the break had not been validly exercised due to the outstanding default interest.

Silence is golden?

The tenant tried to raise an argument, which ultimately failed, that the landlord's failure to mention or demand the default interest might operate as an estoppel, preventing the landlord from arguing that the outstanding default interest invalidated the break. However, an estoppel will only operate in such circumstances where:

– The tenant believes that there are no outstanding sums under the lease and informs the landlord of their belief
– The landlord knows that there are outstanding sums, knows that the tenant thinks there are none and takes advantage of this mistake by remaining silent

In *Avocet* the landlord was not aware of the outstanding default interest until after the break so did not know that the tenant's belief was mistaken.

Quirkco Investments Limited v Aspray Transport Limited [2011] EWHC 3060 (Ch) (Quirkco)

No sum due from the tenant

In a summary judgment case, *Quirkco*, the landlord sought summary judgment in relation to what they claimed was the tenant's ineffective break notice. The lease allowed the tenant to break the lease, but the ability to break was conditional on there being no outstanding sums under the lease and no material breaches of covenant. Under the terms of the lease, the landlord was obliged to insure the premises and the tenant covenanted to reimburse the landlord for the premiums. About a month before the break date, the landlord renewed the insurance premium at a cost of £3,609.72. The landlord sent a demand to the tenant, which was returned with a request that the premium was apportioned until the break date. The landlord reminded the tenant of the break conditions but the tenant did not pay the premium.

In rather unusual circumstances, the landlord's cheque to pay the premium went astray and the premium was actually paid by the landlord's broker, which the landlord subsequently reimbursed. However, the effect of this was that the landlord had not actually paid the premium themselves by the break clause.

The Court held that, on the wording of the lease, because the landlord had not actually expended any money on the insurance premium by the break date, the sums were not due from the landlord so summary judgment could not be given.

No trivial sum

The judge also commented that the sum of £3,609.72 was not sufficiently trivial that the Court would overlook it, neither would a sum which was apportioned as the tenant requested (this would have been some £150). However, the judge was not entirely clear as to whether there could ever be a breach so trivial as to be overlooked by the Court in the case of conditional breaks.

No apportionment

In *Quirkco* the judge made some very clear comments about whether sums due under a lease should be apportioned where the break date falls between quarter days.

1. Rent payable in advance is not apportionable at common law or under the Apportionment Act 1870.
2. The law of unjust enrichment will not help tenants in these situations as it cannot be used to circumvent contractual liabilities – if the contractual liability to pay arises before the break date then the sum must be paid in full.
3. Wording in a lease which describes rent as payable proportionately for any part of a year will also not assist – this wording deals with commencement and expiry of a lease.
4. Only clear wording in the break clause itself will be sufficient for any rent payments to be apportioned back to the tenant.

Harsh conditions

The judge in *Avocet* recognised that this was an extremely harsh result for the tenant and that the pre-conditions even amounted to something of a "trap" for the tenant. However, on the wording of the lease and on the facts of the case, the break would be invalid if any sum, no matter how small, and whether demanded or not, was outstanding at the break date. The judge in *Quirkco* was less clear about whether there could ever be a breach so trivial, in the case of a conditional break, where the Court would simply overlook it.

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Everything's gone green

The last few months have seen the government launching a raft of initiatives aimed at improving the environment and encouraging greater energy efficiency in buildings.

The green agenda is still a priority for the government. On 6th April 2012, important changes came into force in respect of Energy Performance Certificates (EPCs), air conditioning reports and the control of asbestos.

The government has also introduced a "Green Deal" which could be used to finance energy efficiency improvements to commercial properties.

Finally, the government has launched a formal consultation on the existing Carbon Reduction Commitment Energy Efficiency Scheme (CRC) following widespread feedback that it is overly complex.

EPCs

An EPC is now required before marketing a property for sale or letting, whether commercial or residential.

If this cannot be done, the seller must make all reasonable efforts to obtain an EPC within seven days of the property going onto the market. If it has not been obtained within seven days, the seller has a further 21 days to provide the EPC after which they will be in breach of the regulations.

Under the previous regulations, only sellers of residential property needed to ensure an EPC was available before the property was put onto the market. There was no similar obligation for commercial sales and rentals. EPCs only had to be provided at "the earliest opportunity" before parties entered into a contract for sale or lease. The government was concerned that the seller was leaving it until the last minute to provide the EPC, handing it over just before exchange of contracts when it would be too late to influence the decision whether or not to proceed with the transaction.

The government also plans to prevent landlords from letting premises with an EPC rating of "E" or below. This is understood to affect as much as 18% of UK commercial property, some 600,000 premises. It is unclear when this restriction will come into place but it will be before April 2018.

Marketing particulars

As well as the tighter timescale for providing the EPC, the first page of the EPC must be included in the written particulars in respect of both residential and commercial property. The government hopes that this will alert potential buyers and tenants earlier to the recommendations for potential efficiency improvements that are contained within the EPC, so that buyer or tenant can consider the potential costs and benefits.

Data in EPCs

Data in EPCs is to be lodged on a central register and will be publicly available. The government has confirmed that there are already over 7 million EPCs on the register and the number is growing by a million per year.

It will be possible for property owners to opt out of their data being made public.

The government has confirmed that it will be making available bulk EPC data to "selected organisations". This is likely to be the "green deal" providers to enable them to market offers to undertake works in respect of improving energy efficiency.

Sanctions

Sellers or agents acting on their behalf need to ensure that they commission EPCs earlier in their transactions as any breach of the regulations can result in a penalty charge being applied by a trading standards officer. For residential properties the penalty charge is £200 but in the case of commercial properties it varies on a scale based on the rateable value of the property up to a maximum of £5,000.

Air conditioning reports

Changes to the existing regulations have made it compulsory for air condition inspection reports to also be lodged on the central EPC register.

Asbestos

The Control of Asbestos Regulations 2012 also came into force in April 2012. These implement changes required by the European Commission regarding the protection of workers from the risks of exposure to asbestos at work. In practice the changes will mean that far fewer types of lower risk work will be exempt from the three requirements to:

- Notify the work to the relevant enforcement authority
- Carry out medical examinations
- Keep registers of work with asbestos

Contractors will need to consider whether they wish to deal with these responsibilities or sub-contract even simple tasks so that we could see an increase in work for asbestos specialist contractors.

CRC

Following criticism from business that the CRC is unduly complicated and imposes a heavy administrative burden on those businesses and organisations within the scheme, the government is undertaking a formal consultation on whether to simplify the scheme. The government has confirmed that if the consultation is unable to identify significant reductions in the administrative burdens involved, then later in 2012 the government will simply replace the CRC with an alternative environmental tax. This means that the fate of the CRC is unclear. Many experts believe that the CRC will be abolished and replaced with a more straightforward environmental tax.

Green Deal

The Green Deal is the government's initiative under the Energy Act 2011 to allow owners of properties to secure finance to undertake energy efficiency improvements to properties. There are no up front costs for the works to be undertaken (such as loft installation) and the costs are paid for over time in instalments to the energy supplier through the energy bills for the property. The payments will be made by the person who is for the time being liable to pay the energy bills, meaning that the debt will in effect run with the property and attach to the bill for the property rather than the original person who undertook the improvement if they sell the property or are not the occupier paying the bills.

The government has indicated that the Green Deal will be available later in 2012 in respect of residential properties. The government has not yet set a date to roll out the Green Deal to commercial properties, so it is unknown when this will happen. In principle the Green Deal could be used to finance energy efficiency in commercial properties.

If landlords wish to access Green Deal finance, they will be advised to consider their leases to ascertain whether they will be able to recover the costs through the service charge or the outgoings clause. In cases where tenants directly pay electricity charges to the electricity supplier, the tenant's consent to any Green Deal works would be required. Like the CRC, the Green Deal poses difficulties for landlords and tenants and could be a source for dispute between them as a result of their varying interests in the property.

The first national press coverage of the Green Deal was negative, when there was controversy over the so called "conservatory tax", which would have forced people to upgrade the energy efficiency of their homes (so as to boost uptake of the Green Deal) when undertaking extensions. However, as the above shows, the government is pushing on with the green agenda.

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Not so restrictive

Often potential development sites can be subject to restrictive covenants which may limit or prohibit development. Restrictive covenants will be enforceable between the original parties but may also be enforced by one party's successor in title against the other's. It is therefore important for a potential buyer to be aware of any restrictive covenants over the land and the options available to modify or discharge them.

How is an application made?

Under Section 84 of the Law of Property Act 1925 (LPA 1925), an application for the modification or discharge of a restrictive covenant must be made to the Lands Chamber of the Upper Tribunal (formerly the Lands Tribunal) and may be made by any person with an interest in the land.

Once an application has been lodged, the applicant must prepare a publicity notice which is approved by the Tribunal before being served either publicly by newspaper advertisement or directly on the owners of the adjoining land. Objections to the application may be made up to one month after service of the publicity notice. If the application is uncontested, it will take roughly three months for an order to be drawn up by the Tribunal. However, if any objections are received it may take considerably longer and cost more.

What will the Tribunal consider?

When deciding an application, the Tribunal will take into account the historical context and original purpose of the restrictive covenant, the applicant's plans for the development of the land and any local policy or patterns regarding the granting of planning permission applications, as well as any other relevant circumstances.

In order to satisfy itself that it is appropriate to modify or discharge a restrictive covenant, the Tribunal must find that at least one of the following grounds applies:

1 **The covenant is obsolete (Section 84(1)(a) LPA 1925)**

If there have been changes in the character of the land or the neighbourhood since a covenant was put in place, the Tribunal may find that the restriction is now obsolete. This may be the case where the use of the area has changed substantially, such as from farm land to residential land, or where the land has been consistently used in breach of the covenant for a long period. Similarly, the covenant may be obsolete where its original purpose no longer applies, such as a covenant which prohibits the building of commercial properties on the land when the surrounding neighbourhood is now largely commercial. The applicant must identify the purpose of the restrictive covenant to the Tribunal and prove that it is no longer achieving this purpose, following which the Tribunal may decide that the covenant is obsolete and modify or discharge it accordingly.

2 **The covenant impedes reasonable use of the land (Section 84(1)(aa) LPA 1925)**

If a covenant has the effect of impeding a reasonable use of the land and does not provide a "practical benefit of substantial value" to the person who benefits from it (such as rights of access and rights to light), the Tribunal may order the covenant to be modified or discharged. The Tribunal may also modify or discharge a covenant where it is held to be contrary to the public interest.

However, the Tribunal will only modify or discharge a covenant where money would be adequate compensation to the person with the benefit of the covenant. If the modification or discharge would result in the beneficiary losing a significant right for which financial compensation may not be adequate, such as loss of access to part of their own land, the Tribunal is unlikely to consider amending the covenant.

3 **The beneficiaries agree to the modification or discharge of the covenant (Section 84(1)(b) LPA 1925)**

The Tribunal may also modify or discharge a restrictive covenant if all the beneficiaries agree, although there is generally no need to involve the Tribunal since agreement can obviously be reached between the parties themselves. However, the applicant may argue that the beneficiaries have agreed to the modification or discharge of the covenant by implication due to their acts or omissions. For example, where a restrictive covenant prohibiting the construction of any buildings other than private houses had been breached when blocks of flats were built over 50 years earlier, the Tribunal held that the beneficiaries had failed to take action and therefore impliedly agreed to the discharge of the covenant.

4 **The beneficiaries will not be injured by the modification or discharge (Section 84(1)(c) LPA 1925)**

If the applicant is able to establish that none of the beneficiaries of the restrictive covenant will suffer any injury (such as a material disadvantage or financial loss) if the covenant is modified or discharged, the Tribunal can make an order accordingly. This ground is usually relied upon where the existence of the covenant is found to be solely or largely for the purpose of obtaining financial compensation from an applicant, or where vexatious objections are made against a covenant whose discharge or modification will in reality have little or no effect to the beneficiaries.

What orders will the Tribunal make?

If one or more of the above grounds apply, the Tribunal can order the restrictive covenant to be discharged completely or to be modified so that the offending part ceases to adversely affect the applicant. However, a restrictive covenant may not be modified to apply to parties to which it did not originally apply.

In addition, the Tribunal may order the applicant to compensate the beneficiaries of the covenant for the reduction in rights or loss of value to the land caused by the discharge or modification. Compensation will be assessed based on the reduction in the market value of the land without the covenant in place and may, at the discretion of the Tribunal, take into account any potential profit the applicant will gain from having the covenant modified or discharged.

Conclusion

The ability to modify or discharge restrictive covenants, even where the beneficiaries of the covenants do not consent, can be an important tool for developers and may allow them to generate value from sites which otherwise could not be developed. The discretion of the Tribunal does create a degree of uncertainty but it should be possible to navigate through to a successful outcome if the circumstances are right.

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Further advice should be taken before relying on the contents of this summary.

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