What is it worth?

Andrew Francis looks at trips, traps & compensation disputes in restrictive covenant matters

IN BRIEF

▶ How to assess value of property, taking restrictive covenants into account, with relevant case law.

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The increase in demand for housing of all types and at all levels of price and how that can be satisfied has been the subject of much recent debate. This demand has led either to development plans being dusted off, or new ones being created. Such plans require an examination of feasibility, not just as a matter of economics and planning, but also to avoid risks under enforceable property law obligations. As to the latter, the question is—are there risks which might prevent development, even with planning and public authority consents? The most common risk is the potential enforceability of restrictive covenants affecting the development site, if they will be breached. That risk can be encountered on sites which are both large and small and for any types and scales of development. It may be on a site designated for 450 new homes, or on a one-acre site for two blocks of flats, or an extension to an existing building, or a single new dwelling in a rear garden.

The basic law

This article is not about the hurdles which have to be overcome to reach the stage of the elimination of risk, such as ruling out breach (an issue which often fails to be asked at the first stage) or the absence of anyone to enforce the covenants, or by the use of an indemnity policy. Nor is this article about the procedural steps that can be taken in the courts, or the Upper Tribunal (Lands Chamber) (UTLC) to enforce, declare, discharge, or modify rights and obligations under covenants. What this article is about is the law which applies when the value of the rights are being assessed either in negotiations (eg to release the covenants) or in litigation in court (eg damages in lieu of an injunction) or in the UTLC where compensation to make up for the effect of the discharge, or modification in an application under s 84(1) Law of Property Act 1925(s 84(1)) is the issue.

Recent demonstrations of the basic law

Two recent decisions of the UTLC demonstrate that law. It is hoped that the explanation below will not only set that law out clearly, but will avoid advisers adopting the wrong approach in terms of the advice to clients, the stance taken in negotiations and in positions taken in litigation, whether in court, or in the UTLC.

The law may be summarised by three propositions.

First, when assessing damages for breach of covenant in lieu of an injunction (under s 50, Senior Courts Act 1981) (damages in equity) where one measure may be based on 'negotiating damages' (after *Morris-Garner v One Step (Support) Ltd* [2019] AC 649, [2018] 3 All ER 659) and calculated by reference to the net uplift in value accruing to the party in breach, if its work is not to be prevented by injunction and if damages are to be awarded in lieu, the court may have regard when assessing those damages to the compensation which the UTLC would award if the covenant was to be discharged, or modified there under s 84(1) (the UTLC compensation factor).

The damages may be limited to loss caused by the breach of covenant, such as loss in capital value. This factor would not apply if the jurisdiction under s 84(1) was inapplicable, or excluded, or if the prospects of success under s 84(1) were remote. The UTLC compensation factor does not apply in disputes over other property rights such as easements where there is no jurisdiction akin to s 84(1) applicable to them. The UTLC compensation factor arises where the party in breach cross-applies under s 84(9) to stay a court claim for the injunction pending the outcome of the s 84(1) application. The 'double-hatting' procedure can be used to enable both the court claim and the s 84(1) application to be heard together. The judge can then consider the application of this factor when assessing damages when wearing the court 'hat'. Finally, this proposition is qualified and does not apply to damages in court claims where there have been historic losses to the claimant recoverable as common law damages; eg where the work in breach has already damaged the fabric of its building. As will be seen below, propositions two and three form the basis of this proposition and can have a major effect on the expectations of the 'innocent' party.

Secondly, the UTLC will not grant compensation under s 84(1) based on what the negotiating damages might have been. This is a crucially important principle which can be overlooked where covenants are the subject of release etc negotiations and where the question of the price is key. Analysis of the background to that principle, established by a series of authorities going back to 1974, is beyond the scope of this article. The warning that a failure to apply this principle leads to unrealistic hopes in covenantees/objectors was given by Carnwath LJ in *Winter v Traditional and Contemporary Contracts Ltd* [2007] EWCA Civ 1088, [2007] All ER (D) 110 (Nov). He said: 'Against that background [the earlier decided cases of *Re SJC Construction Ltd* (1975) 29 P&CR 322, or *Stockport MBC v Alwiyah Developments Ltd* (1983) 32 P&CR 238] we find it surprising that, almost a quarter of a century later, this basis of claim is still being advanced by valuers and advocates (as in *Skupinski* [AUTH: *Re Skupinski's Application* [2005] RVR 269?] and this case). This can only create unrealistic hopes in objectors, thus delaying settlement and aggravating the loss and anxiety which the section seeks to compensate.'

It is disappointing that this warning is still being ignored in some cases 17 years after it was given. If overlooked in litigation (whether in court, or the UTLC) it will lead to expert valuers being instructed on the wrong basis and dealing at great (and expensive) length with net development values, uplifts and Stokes-type percentages. This principle seems to apply both to absolute as well as qualified covenants and as between the original parties to the covenants; see *Father's Field Developments Ltd v Namulas Pension Trustees Ltd* [2021] UKUT 169 (LC). The writer considers that this principle is unsatisfactory, if not wrong. But unless the Supreme Court, or Parliament changes the law so as to free up the basis of assessment (see Lord Carnwath at paras 143-152 in *Morris-Garner*) a restrictive covenant is potentially valueless unless there is evidence of loss in the capital value of the covenantee's land. This proposition seems to have been overlooked by the advisers to the objector in *Father's Field* when it sold off the remainder of the benefited land to the covenantor. That would have been the time to agree overage terms with the latter, but that was not done. The old adage that a restrictive covenant is a bad way of securing uplift was borne out there. Finally, it is clear that the opening proposition will apply whether compensation is sought under either s 84(1)(i) (a sum to make up for the effect of the discharge, or modification) or s 84(1)(ii) (applicable where the covenant when imposed reduced the consideration then received for the land

affected by it).

The third proposition is that the loss in value of the covenantee's property is the primary measure of compensation under s 84(1)(i) if the UTLC decides to grant the application on payment of compensation under it. The alternative measure under s 84(1)(ii) will produce its own value, if there is evidence to support it. On that latter measure, *Father's Field* is a reminder that the question under it is not whether the price paid by the covenantor was a good, or bad one when the covenant was imposed, but whether the covenant had a depressing effect on that price. Remember that in considering applications under grounds (aa) and (c) of s 84(1) whether the practical benefits secured by the covenant are of substantial value, or advantage, or whether the proposed discharge, or modification will not injure the objector will be determined by that loss in capital value, if any. Evidence of uplift and 'negotiating damages' is never part of that assessment. That is because any sum which the applicant might seek to recover on that basis is not a 'practical benefit' under ground (aa) and as there is no right to receive a sum so calculated, that is not part of any 'injury' under ground (c); see *Stockport*, above. One final practical point may be made as regards assessing the loss of capital value in s 84(1) applications. This is demonstrated on the evidence considered by the tribunal in *Moskofian v Foster* [2021] UKUT 0214 (LC). That application succeeded under ground (aa) on terms as to the payment of compensation and some other conditions relating to the proposed development on the applicant's land at Ealing.

Three lessons emerge from that decision. They are of importance to advisers and experts.

First, the UTLC (and the court) like it when the experts agree matters, such as the current capital values of the objectors' properties. There is no reason why this should not be more common.

Secondly, where the application is under s 84(1) the expert must be instructed on a proper basis, retain those instructions and supporting materials and observe the requirements of the relevant professional bodies, UTLC Procedure Rules r 17, UTLC PD para18, and if in court, CPR Part 35.

Finally, in the light of the evidence relating to the objectors' expert witness in *Moskofian* and the member's assessment of it, it is wise to have read and understood the terms of s 84, or any other statutory provision on which the expert's evidence will be based; eg s 610, Housing Act 1985. The expert valuer for the objector must be careful to be aware of the margin when considering market value and not be tempted to over egg the loss in values and express that in percentages which are extreme, bearing no relation to reality. That may show a lack of objectivity. The same guidance applies to the applicant's expert, such as a refusal to acknowledge even very small effects on values caused by the proposed development. In *Moskofian* the objectors' expert witness gave evidence that the loss of value of the objectors' properties was up to 12%. The member found that the greatest loss was 4.8% on one property, with the other ten properties affected suffering losses of 1% or 2%; so none were substantial. The contrast between that the objectors' evidence and the findings of the tribunal speaks for itself.

Summing up

The explanation above should make it clear that the question, 'what is it worth?' is not to be answered without a full understanding of the case law, with care being taken to reach the proper and justifiable answer to it, even if that may not be the clients' preferred one. The two recent decisions of the UTLC demonstrate all of these points and are worth studying. NLJ

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