

A Tuffin Ferraby Taylor White Paper
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Long-established dilapidations law and principles are challenged in the recent PGF case

PGF II SA v Royal & Sun Alliance Insurance [2010]

In 2008, the claimants, PGF, were the landlord of a six-storey office building in Lime Street in the City of London. The building was let to Royal & Sun Alliance (the first defendant) under a 35 year lease until 24 June 2008 and, in turn, sub-let to London & Edinburgh Insurance (the second defendant) on a sub-lease expiring four days before the expiry of the head lease.

Following lease expiry, PGF spent £5 million refurbishing the building and sought to claim about £4 million plus interest in damages from the two defendants for their failure to reinstate the building. The claim included a substantial sum for loss of rent. Both defendants admitted that the building had been handed back in disrepair, but disputed the claim on grounds of the building's alleged latent development value (i.e. worth more to the landlord refurbished/developed than in full repair) and of supersession.

A key part of the claim related to the cladding, which PGF had replaced. The defendants disputed liability for the cost of repairing the cladding on the basis that the repairs had been superseded by the landlord's replacement of the cladding and that repairs could have been undertaken at substantially less cost.

Interestingly, the defendants challenged a number of principal dilapidations cases and statute in relation to how damages are measured and substantiated and, thus, the case makes good reading for anyone wishing to understand the evolution of dilapidations in the context of a recent case relating to a modern office building.

When making his judgement, Judge Toulmin reviewed certain aspects of the law of dilapidations in detail. His starting point was *Joyner v Weeks* [1891], which is the principle case that, historically, provided the precedent for the common law measure of loss - that being the cost of the repairs plus any provable loss of rent for the period during which the repairs were carried out. Section 18(1) of The Landlord & Tenant Act 1927 sought, subsequently, to remedy any potential injustice in relation to the inflexibility of this rule and to the measure of damages. The Act imposed a cap on the damages a landlord could recover, so a landlord no longer had an automatic right to recover the cost of the repairs. Therefore, the two limbs of S18(1) in conjunction with *Joyner* (a combination of statute and common law) provided the method of valuing dilapidations at lease expiry still used to this day.

The general law on damages to be applied in dilapidations cases became very pertinent in PGF because the defendants argued that the law had changed since the decision in the House of Lords in *Ruxley Electronics v Forsyth* [1996]. Indeed, in his judgement, Judge Toulmin notes that in a number of recent decisions the courts have indicated that *Joyner v Weeks* might have been decided differently had it been decided after *Ruxley*. Consequently, it was necessary for Judge Toulmin to consider the case law since 1927, and particularly *Ruxley*, in which the House of Lords said that damages should reasonably compensate the landlord, but not be "out of proportion to the benefit to be obtained".

In *Ruxley*, the judge had also considered the issue of the landlord's intentions in relation to damages and in PGF, Judge Toulmin looked at this ruling closely. In PGF, the defendants argued that the landlord intended to replace the cladding at lease expiry and that the property had latent development value giving rise to the argument that there was no diminution in the value of the reversion whatever state the premises are left in.

Confirming that it is the landlord's intention at lease expiry that matters, Judge Toulmin rejected the defendant's argument that the latent development value of the property at that time should be taken into consideration. He said that this point had not been successfully argued in the 83 years since the statutory ceiling on damages was introduced by S.18(1) of the 1927 Act. At lease expiry the landlord had not decided to replace the cladding and if the tenant had left it in repair, the landlord would have retained it. Consequently, the judge ruled that PGF could recover reasonable repair costs.

However, the judge accepted the defendant's cladding expert's advice that the cladding was capable of repair leaving it maintainable for another 10 years, the period for which a new letting was likely to be for. Therefore the claimant was only able to recover the cost of repairing the cladding, thus reducing the claim significantly. The judge also awarded one sixth of the loss of rent claim on the basis that PGF would have undertaken the works in any case.

Importantly, in this case, Judge Toulmin considered the Section 18(1) valuations provided by experts for both parties, in conjunction with the relevant common law and statutory principles of dilapidations. On the basis of the substantial agreement the experts had reached and the judge's findings on the disputed items, the experts were able to reach a final agreement on the diminution in the value of the reversion.

Despite elements of the claim being unreasonable, the judge found for the claimants against both defendants. Costs were awarded to the claimant.

Lessons learnt

1. Claims for the replacement of significant building components (in this case, the cladding) are unlikely to be successful if the item in question can be repaired to an extent that it is maintainable for the duration of a new letting (in this case 10 years).
2. The various arguments used by the defendants in this case demonstrate the scope for the robust defence of a dilapidations claim and, therefore, the need for a landlord's claim to be expertly prepared.
3. The common law measure of loss in conjunction with Section 18(1) of the Landlord & Tenant Act 1927 remains the best way of assessing the diminution in the value of the reversion i.e. the landlord's loss, but where larger claims, generally, are concerned, S.18(1) valuations will inevitably be considered by the Court as part of the solution and, thus, parties are advised to consider these early.
4. When considering a tenant's defence based on latent development value and potential supersession, it is the landlord's intention at lease expiry that matters.
5. Claims for loss of rent, where valid, must be reasonable and take into consideration the landlord's intentions at lease expiry.
6. Dilapidations matters remain complex and a knowledge of dilapidations law is more important than ever, so landlords and tenants are well advised to seek expert advice early on.