DILAPIDATIONS Claims for Damages for Breach of Contract

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Michael is a solicitor who has specialised on property litigation and risk management for most of his career and is a strong advocate of a proactive approach to the management of commercial risks associated with owning and occupying property. Within his field of work, Michael has a particular expertise in relation to legal issues relating to telecommunications matters and property, for example, issues relating to phone masts [Ed – see 2019 Autumn Terrier]. He also has extensive experience in relation to commercial property dilapidations claims. He regularly presents CPD seminars both in-house and for commercial CPD providers and he is also the founder of the Linkedin Dilapidations Discussion Forum and Interest Group which has in excess of 2,500 members.

Michael presents a comprehensive and practical guide to what is a dilapidations claim and how to settle them. "The whole culture of dilapidations claims is that it is just a process of negotiation between surveyors" – clearly it is not, so be prepared to end up in a court of law.

Dilapidations is something that many professionals involved in commercial property will be familiar with. Some will be dealing with dilapidations personally on a day to day basis, whereas for others it will be something they come across infrequently. For many with responsibility for managing property assets, it may be an area of their work in respect of which they seek external advice and support, whether presenting a claim or responding to one. For anyone with budget holder responsibility, or the responsibility for reporting to a budget holder, they presumably need to make sure that recommendations and decisions they make in relation to such claims are proper and justifiable. In short, if settling a claim they ought to be confident that they or their client are not paying over the odds, and if making a claim, they may want to be sure that they are recovering that which is properly due and owing.

The aim of this article is to take a step back and consider precisely what a dilapidations claim is, to pose a few questions as to how they are conventionally dealt with and hopefully to inspire the reader to question whether conventional wisdom is really the best way forward when recommending or sanctioning settlements of such claims.

What is a dilapidations claim?

A dilapidations claim is a claim for damages which are properly recoverable at law as a consequence of alleged breach of contract.

It follows from this that to advise properly on such a claim, one probably should have a good knowledge of matters such as the rules relating to the interpretation of contracts which have been developed by the courts over the years. For example, what actually is the difference in terms of contractual obligation between a contract which obliges a party to keep premises in "good repair" and a contract which requires the premises to be kept in "good and substantial repair and condition"?

When interpreting a contract, the courts will proceed on the basis that every word that was written in the contract was put there by the parties because they wanted it there and intended it to have a purpose. Accordingly, the inclusion of the words "substantial" and "condition" means the parties intended something other than just an obligation to keep the property in "good repair".

Proper analysis of the precise nature of the contractual obligations is something that is very often overlooked by those who present or respond to such claims on behalf of landlords and tenants. It is not unknown for those preparing such claims and presenting them by way of a schedule of dilapidations to overlook this fairly basic requirement. In the case of Latimer v Carney in the Court of Appeal, Lady Justice Arden observed: *"The judge found that Mr Hughes did not have the lease covenants before him when he prepared his schedule of dilapidations".* In short, a landlord pursued a claim for damages for breach of contract all the way to trial (and ultimately to the Court of Appeal) in circumstances where their expert witness hadn't actually read the contract.

Understanding the precise nature and extent of the repairing and other contractual obligations entered into by the tenant is fundamental to successfully pursuing or defending a claim for dilapidations damages. If we do not know exactly what the contractual obligations are, then there is little prospect of properly opining as to whether there has been a breach of contract.

The full extent of the contractual obligations may not only be within the lease, but may be found in a variety of other documents such as licences to alter, deeds of variation and even licences to assign. Any landlord or tenant faced with the prospect of a dilapidations claim would be wise to undertake a thorough process of due diligence, to establish precisely what condition and configuration the tenant is obliged to deliver the property back to the landlord.

Those instructing professionals to advise in relation to such claims would be well served in stress testing their advisers and looking to define precisely what it is that they are being required to do. Are they being asked just to haggle a deal, irrespective of and unrelated to the proper extent of legal liability, or are they being retained to provide a proper forensic analysis of a claim for damages recoverable at law?

The key point is that on day one when the parties entered into the contract, they agreed what they will have defined as the "demised premises" that should be handed back to the landlord and also, the condition the demised premises should be handed back in. The configuration and condition in which the demised premises should be delivered up may be readily ascertainable from the lease alone, or it may also be necessary to consider other documents such as licences for alterations etc.

For landlords, this is a process that they would be wise to undertake well in advance of the expiry of the contractual term, so as to ensure that any notices to reinstate alterations that may be required can be served on the tenant in good time.

A dilapidations claim is, therefore, a complex legal claim for damages and the key to setting off on the right foot for both landlords and tenants is to identify precisely what the contractual obligations are, and having done that, only then can one move to inspect the property and consider whether the tenant has actually complied with their contractual promises.

Damages

A schedule of dilapidations will conventionally set out a list of items which are alleged to constitute breaches of

contract on the part of the tenant, along with a proposed remedy and the view of the landlord (or their professional advisers) as to the cost of remedying each breach of contract. This will often then be presented as the landlord's "claim". In most cases, the schedule will be prepared by a surveyor retained by the landlord and the tenant will likewise retain a surveyor to respond to the schedule. The product of this process will be two positions which are set out by the parties as representing their view on the merits of the claim for damages. Thereafter, a process of negotiation may ensue in the form of a horse trade, whereby the parties move towards agreement of a sum to be paid by the tenant to the landlord.

This process of haggling may be quite acceptable to the parties, in that it may produce a commercially acceptable outcome which both can live with and move on from; however, it may have no relation to the actual damages to which the landlord is properly entitled as a consequence of the tenant's breach of contract. Tenants in particular, and those who advise them, may just want to step back, take stock and consider whether the proposed sum in settlement really is that which the landlord is entitled to by way of damages recoverable at law. In particular, anyone with responsibility for disbursing public funds should be diligent to make sure that they know whether they are sanctioning a donation to their former landlord or the payment of a properly due sum by way of damages.

Both at common law and pursuant to statute, the damages to which a landlord is entitled are limited to the diminution in value of the landlord's reversionary interest consequent upon the proven breaches of contract. If the landlord has actually spent money and undertaken the works then this may be prima facia evidence of damage to the reversion.

Any tenant in circumstances where settlement of a claim is recommended by their advisers should ask themselves whether the sum they are being advised to pay really does represent their liability for breach of contract. That is to say, does it truly represent the loss the landlord has suffered by way of diminution in the value of their reversionary interest, or is it just the product of a haggle between advisers as to a sum to be donated by the tenant to the landlord?

When does liability for dilapidations arise?

Dilapidations is often considered to be something to be dealt with at lease end, by way of a claim for damages for breach of contract arising from the tenant's failure to deliver the property back to the landlord, in accordance with the promises they made in their contract with the landlord. Those promises are not made at the end of the lease. A tenant promising to keep a property in good and substantial repair and condition makes that promise on day one and therefore they should do exactly that. If they don't want to decorate the exterior of a property every 3 years, and the interior every 5 years, then they should not enter into solemn contractual promises to do so.

It is not unknown for landlords and those who advise them to be very forgiving of tenants who fail to maintain their premises during the term, with the consequence that they are then left to pursue a damages claim after the tenant has vacated the property. This often leaves the landlord with a vacant unit that needs substantial works before it can be returned to being an income generating asset.

It also means that the landlord is pursuing a remedy against a tenant who no longer has an interest in the property and in circumstances whereby the landlord may be at their weakest position. This is because of the ability for the tenant to challenge any claim on the basis of the extent to which the reversionary interest value is diminished, thereby requiring the involvement of valuation experts as well.

For tenants, of course, it may make perfect sense to try and drag everything out until the expiry of the lease when the landlord will indeed be at their weakest.

Any properly drafted modern lease of commercial property should contain a Jervis v Harris clause, which enables the landlord to serve notice on the tenant requiring them to repair the property and if they do not, the landlord is then permitted to enter the property, carry out the necessary remedial works and then recover the cost from the tenant. This is a powerful mechanism for landlords and while it requires a degree of commitment from the landlord, in terms of being willing to enforce the terms of the contract and to spend money in doing so, it can be a very powerful and cost effective way of enforcing the tenant's contractual promises.

Rather than waiting until the end of a lease, landlords would be well served by reviewing the condition of the property regularly, and certainly a couple of years prior to the end of the term, so as to evaluate whether the tenant is complying with their repairing obligations. If they are not, then early deployment of the repair notice mechanism could be a prudent move.

Similarly, any tenant faced with a repair notice should take it seriously and review the extent of compliance with the contractual promises they have made to their landlord.

Progressing claims

It is not unknown for dilapidations claims to become exceptionally protracted with repeated rounds of schedule, response, amended schedule, further comments, further response and so forth but really this should not be necessary? Both parties are looking at the same contract, the same property and the same evidence as to the condition of the property at the material date. Theoretically, their respective experts should come up with the same conclusion in terms of the extent of breaches of contract, the required remedies, and the cost of remedial works. Inevitably, they do not, and this can then lead to months and sometimes years of "negotiations" in which the experts trade off their positions against each other.

It needn't be like this. A landlord who is properly advised and has confidence in their advisers should have no concerns about pursuing their claim if not settled in good time by the tenant. If they are properly advised as to the quantum of damages to which they are entitled, then if the tenant does not settle their claim, they have 3 options:

a. Walk away and move on in life

b. Take whatever sum the tenant might deign to offer - if any, or

c. Put the claim into court and let the judge tell the tenant to pay the damages that are properly due.

Very often landlords seem reluctant to take a robust approach to recovering that to which they are legitimately entitled, but in the absence of a satisfactory payment of damages by the tenant, moving swiftly

to place the claim before the courts has a number of advantages. The first, and probably most obvious, is that it lets the tenant know that the landlord is serious about recovering that which is properly due to them. Unless the tenant genuinely believes that they have no liability whatsoever, then they are exposed to cost risk and need to start taking some realistic decisions about their liability very early in the process.

Secondly, a landlord who moves quickly to place their claim before the courts is effectively litigating at the tenant's expense until the tenant makes a realistic offer of settlement. This can really focus the mind of the tenant and drive them to make an early and realistic offer of settlement, resulting in a swift conclusion to the matter.

For tenants, rather than engaging in a protracted process of haggling, an early and realistic assessment of their liability can be used to inform a pre-emptive offer of settlement. If they are confident of their position (and their advisers), then they can simply stand fast and leave the landlord either to accept the offer or put the matter into court, knowing that the cost risk has been significantly shifted by the early offer. Landlords are often reluctant to take on the risk of litigation in those circumstances and a carefully formulated pre-emptive offer can prove to be a catalyst for an early cost effective resolution.

All too often dilapidations claims drag on and on which is rarely in the interests of either party, whereas a robust and decisive approach can be beneficial for both landlords and tenants, in that it can facilitate the swift resolution of damages claims. Ultimately, if a tenant will not make an offer that is acceptable to the landlord, then the landlord who wishes actually to recover the damages to which they are entitled has only one option, which is to put the matter before the courts and let the judge give the parties the answer as to what the recoverable damages are.

Evidence

If the landlord has to resort to pursuing their claim at court, then they will be entirely reliant upon credible expert witness evidence. They have the burden of proof and therefore they have to convince the judge as to the breaches of contract and their entitlement to damages.

Similarly, any tenant defending such a claim will be reliant upon the evidence and opinions of their expert witnesses and to this end, it is important that expert witness surveyors engaged in dilapidations by both landlords and tenants are absolutely clear as to what is required of them from day one.

An initial schedule that turns out to be exaggerated, or a response that is understated, could be fertile grounds for cross examination should the claim need to proceed to trial. One thing for advisers to look at is an early evaluation of the credibility of their opponent's expert witness(es). Assessing an opponent's expert as being lacking in credibility because an early schedule or response does not stand up to scrutiny may expose weaknesses which can inform tactics and strategy going forward.

Any surveyor acting for a landlord in a dilapidations claim must bear in mind from day one that if the tenant will not engage, and effectively tells the landlord to "get lost", then they may find themselves taking an oath and presenting their evidence in support of the landlord's claim for damages. If the claim does progress to this stage, then they are also likely to find themselves being cross examined by counsel for the tenant. Standing in the witness box is too late in the day to start thinking about contractual interpretation and the standard of repair. If this is not correct from day one, then the landlord does not have a credible expert witness to put before the court and will not have the option of being able to pursue a claim for the damages to which they are legitimately entitled.

Similarly, a tenant who is seeking to defend a claim but has issues of credibility with their expert witnesses, may find themselves in a difficult and expensive predicament if faced with a determined landlord.

Of course, most dilapidations cases do settle so does it really matter whether a surveyor presenting a claim or responding to one is able to be a credible expert witness?

Inevitably parties engaged in a dilapidations claim will participate in discussions, negotiations and possibly even mediation. The positions taken by either party in those attempts to resolve the dispute will be informed by an assessment of the strengths and weaknesses of their own position, compared with the strengths and weaknesses of their opponent. There will be evaluation of risk and the merits of the opponent's case and this risk assessment will be constantly reviewed and updated as the claim progresses. Any party who considers that the expert witnesses retained by their opponent lack credibility will be encouraged in their pursuit or defence of the claim, and properly advised parties will be looking for opportunities to influence the negotiation process by promoting the confidence and credibility of their own expert witnesses, and exposing the weakness of those retained by their opponent.

Being a credible expert witness is of itself not a simple task. There are rules, guidance and standards set out by the Civil Procedure Rules, the Civil Justice Council, the RICS and the courts in judgments over the centuries.

On day one when that instruction to prepare a schedule of dilapidations, or to prepare a response, is given, no one knows whether that is the one case which will result in the surveyors taking an oath and giving expert evidence. It is, however, important for their clients to have that option because if they do not, then capitulation is the only other option if faced with a robust opponent.

In order to ensure that they are not compromised further down the line, landlords and tenants would be wise to make sure that surveyors instructed in dilapidations claims are given formal expert witness instructions from day one that make it clear they are being instructed in a capacity that may ultimately require them to present evidence at court. Issuing formal expert witness instructions should mean that there is no confusion on the part of the expert and that it does not come as a surprise to them if they find themselves engaged in a process of litigation and court reporting.

Formal instructions can make it clear to the expert what guidance and duties they have and should be following. To be able to show they were cognisant of this from day one adds to their credibility, should the matter need to proceed to expert witness reporting and the giving of evidence.

Some professional indemnity insurance policies do not include cover for expert witness work and therefore this can be checked on day one, rather than the landlord or tenant finding out that their expert does not have this cover - just when they need it the most.

Conclusion

Dilapidations claims are complex claims

for damages recoverable at law in respect of alleged breach of contract. Many are resolved by a process of haggling, but in many instances the outcome is not directly related to the actual liability of the tenant for damages that are properly recoverable at law.

For those who instruct professionals in relation to such claims, and are accountable for the outcomes, then it is important critically to evaluate the advice that is being provided and to understand whether it is a proper forensic analysis of the damages that are recoverable at law, or merely the product of a process of haggling and horse trading. Indeed, those instructing professionals should make clear what they expect by carefully formulated instructions that are specific as to what is required.

The whole culture of dilapidations claims is that it is just a process of negotiation between surveyors, but the law reports are full of instances where parties, for whatever reason, did not resolve the damages claim by haggling and they have sought the determination of a judge. There are also many cases where the claimant or defendant have suffered serious consequences as a result of the failure of their expert witnesses on the day in court. Such consequences are often reflected in costs orders made by the courts and can be very expensive.

To this end, those engaged to advise in dilapidations claims would be well advised to keep in mind that their client's ability to seek a just determination of the damages due may be entirely dependent on their ability to give cogent and credible evidence on oath. Unless one party is prepared to capitulate, every case has the potential for being determined before the courts. Of course most do not go that far, but it is probably better to prepare from day one as though it will, and that way the client will not be disappointed.

For landlords and tenants, it is worth making sure that retained advisers are properly instructed from day one and understand that they may be required to present evidence to a court. As the saying goes: "If you want peace prepare for war".