Compare & contrast: three lessons from the courts on covenants


Marble Arch / Edgware Road

Basingstoke Railway Station

Berkeley Square

Why is the ability of a tenant to modify certain restrictive covenants in leases under s 84(1) of the Law of Property Act 1925 not better known, asks Andrew Francis

IN BRIEF

- The decision in *Edgware Road*.
- Comparisons with *Shaviram* and *Berkeley Square*.
- Practical suggestions.

At first sight there is not much in common between a vacant 1980s office building near Basingstoke Railway Station, a mid-eighteenth century Grade I townhouse and a Grade II mews house of the same period, on the west side of Berkeley Square in Mayfair and finally, part of a 1960s development (formerly used as offices) on the west side of the Edgware Road, less than half a mile north of Marble Arch. The tenant of each property wanted to modify the user covenant in its lease. While the locations and properties were different, the commercial and economic interests of the applicant tenants were aligned, as were the interests of the respondent landlords. In each application there was a long lease held by the applicant, a restrictive user covenant, the grant of planning consent for a use outside that covenant, the desire by the tenant to implement that planning consent and the refusal by the landlord to allow it, mainly for estate management reasons.

In the first case the tenant wanted to convert the building to flats. In the second the tenant's proposed use was for a private members' club. In the third the tenant's proposed use was for a hotel. There is one other common factor. Each was an application to the Upper Tribunal (Lands Chamber) (UTLC) by the tenant within s 84(12) of the Law of Property Act 1925 (the Act) to modify the user covenants under s 84(1) of the Act. The applications were decided by the UTLC and are respectively *Shaviram Normandy Ltd v Basingstoke and Deane Borough Council* [2019] UKUT 256 (LC) (*Shaviram*), *Berkeley Square Investments Ltd v Berkeley Square Holdings Ltd* [2019] UKUT 384 (LC) (*Berkeley Square*), and *Edgware Road (2015) Ltd v The Church Commissioners for England* [2020] UKUT 104 (LC) (*Edgware Road*). In the first two decisions the tenants' application to modify the user covenants succeeded. In the third it failed. This trio came after a long period when there were very few decisions on tenants' applications under the Act with less than ten reported decisions since the judgment of the Court of Appeal in *Ridley v Taylor* [1965] 1 WLR 611, [1965] 2 All ER 51 over 55 years ago. Either because of the terms of that judgment weighing against tenants' applications, or because leases can be modified under other statutes, or because of ignorance of the jurisdiction, these applications are rarely encountered. This trio is useful, as it brings this jurisdiction into the light.

This article looks principally at the decision in *Edgware Road* and draws some comparisons with the outcomes in *Shaviram* and *Berkeley Square*. Some practical suggestions are offered for those readers who may be faced with advising on a tenant's application under s 84(12)

The decision in Edgware Road

The basic facts in this application were simple. Since May 2017 the applicant (A) had held a long lease granted in 1991 for a term of 125 years (the lease) of part of the Church Commissioners' (R) 1960's development (The Water Gardens) in the Edgware Road. A had been granted planning consent on appeal in March 2018 to change the use of the first and second floors and part of the basement demised by the lease from offices to a 'pod-type' hotel. This grant was consistent with the Westminster City Council's policy in support of hotel use. If implemented, that would have caused a breach of A's user covenant in the lease. There was no 'keep open' covenant. R refused to modify the covenant. The application was made to the UTLC in 2018 under grounds (aa) and (c) of s 84(1). Having disposed of a preliminary point of jurisdiction the tribunal considered the application on its merits. The evidence of fact concerned the nature of the proposed hotel, its viability and its impact on R's Hyde Park Estate (the estate—a diverse one consisting of some 2,300 residential and commercial properties within an area of about 90 acres north of Hyde Park) both in terms of immediate impact (eg, anti-social behaviour) and in terms of R's overall strategies for land use within the estate. The

expert evidence from the parties' respective valuation surveyors on whether the restrictions in the lease provided substantial practical benefits (in terms of value) or advantages to R revealed a huge gap between them. It was, as the tribunal said, to the credit of A's expert, Mr Ruaraidh Adams-Cairns FRICS, of Savills, that 'he was clearly troubled' by that difference. His conclusion was that A's proposal would result in no material injury, loss, or disadvantage to R and no impact on the value of its reversion in The Water Gardens, or of the estate. R's expert considered that the diminution in the value of The Water Gardens would be not less than £900,000 and to the rest of the estate, at not less than £40m. The latter was mainly attributable to the 'thin end of the wedge' caused by the application being allowed with its effect on the 'book value' of the estate.

The tribunal found in A's favour that (a) the hotel would not have any effect on the amenities of the residents in The Water Gardens, so the claimed £900,000 loss was rejected and (b), as to the wider estate, the evidence of the £40m loss put forward by R's expert was speculative and any diminution in *value* of that estate 'is in truth immeasurable'. The key question was whether the control which R could exercise over its estate by its covenants secured practical benefits of substantial *advantage*. If that was the case, the inability to measure *the value* of those benefits in financial terms did not prevent the tribunal refusing the application. The tribunal gave two reasons for refusing the application. First, R's estate management strategies for its estate depended on the use of its freehold and leasehold covenants. R pursued its strategies by the use of covenants to model and remodel its estate, and secured compliance with them. R considered the hotel proposal inconsistent with its aspirations for the Edgware Road. Second, the effect of allowing the application would be to make it more likely that other applications on the estate would succeed; the 'thin end of the wedge' (or precedent) effect. The tribunal considered that if this application succeeded 'there will be blood in the water'. That was significant as the diverse estate was not a residential one where there were uniform covenants. As the tribunal concluded, while the proposed hotel use was a reasonable one, the application failed because 'the ability of {R} to exert control over this corner of the Estate through these restrictions is of significant benefit to {R} in the management of their interests'.

Comparisons matter

In *Shaviram* the tribunal found (as in *Edgware Road*) that the continued office use did not secure a practical benefit of substantial value to the council, when compared with the effect of residential use on its reversion. In *Shaviram* the tribunal, having considered the effect of the proposed use on the council's land holdings in the neighbourhood of the applicant's building in contrast with *Edgware Road*, rejected the council's argument that allowing the application would weaken the covenants over its estate ('the thin end of the wedge') and that retaining the use of the applicant's building would not make a significant contribution to the wellbeing of Basingstoke. So the user covenant did not secure any substantial benefit of practical *value, or advantage*. While each application under s 84(1) must depend on its own facts, it is curious that in *Shaviram,* the conclusion was that modification of the covenant would not affect the council's estate management strategy; whereas in *Edgware Road*, the value of R's control over its estate was of significant value and should not be weakened. This was despite the fact that the user covenant (with no 'keep open' terms) was, at best, an indirect means of promoting R's office strategy when set in a diverse estate. To that extent the outcome in *Edgware Road* is surprising.

The comparisons between *Edgware Road* and *Berkeley Square* may be summarised as follows. While the respondent in *Berkeley Square* was coy about revealing the extent of its investments, it submitted that the diverse nature and extent of its 'estate' in Mayfair and the control and management of that 'estate' lay at the heart of its objection to the modification of the user covenant. That was found by the tribunal to be a practical benefit. As in *Shaviram* and *Edgware Road*, in *Berkeley Square* the proposed user would not damage the value of the landlord's freehold reversion. In *Berkeley Square* there was no evidence that if successful that would be the 'thin end of the wedge'. So the preservation of the office user covenant would not amount to a practical benefit *of substantial value, or advantage*. This was because the landlord produced no evidence of leases in its 'estate' where the user covenants might qualify for modification under s 84(12) and because it did not refer to any other comparable buildings on its 'estate' as suitable for conversion to a private members' club. Save for the absence of any loss to the value of the reversion, the facts in *Berkeley Square* are at some remove from those in *Edgware Road*. What the former decision shows is that if the landlord relies on

Extracts from s 84 of the Law of Property Act 1925

(1) The Upper Tribunal shall (without prejudice to any concurrent jurisdiction of the court) have power from time to time, on the application of any person interested in any freehold land affected by any restriction arising under covenant or otherwise as to the user thereof or the building thereon, by order wholly or partially to discharge or modify any such restriction on being satisfied—

(a) that by reason of changes in the character of the property or the neighbourhood or other circumstances of the case which the Upper Tribunal may deem material, the restriction ought to be deemed obsolete; or

(aa) that in a case falling within subsection (1A) below the continued existence thereof would impede some reasonable user of the land for public or private purposes or, as the case may be, would unless modified so impede such user; or

(b) that the persons of full age and capacity for the time being or from time to time entitled to the benefit of the restriction, whether in respect of estates in fee simple or any lesser estates or interests in the property to which the benefit of the restriction is annexed, have agreed, either expressly or by implication, by their acts or omissions, to the same being discharged or modified; or

(c) that the proposed discharge or modification will not injure the persons entitled to the benefit of the restriction:

and an order discharging or modifying a restriction under this subsection may direct the applicant to pay to any person entitled to the benefit of the restriction such sum by way of consideration as the Tribunal may think it just to award under one, but not both, of the following heads, that is to say, either—

(i) a sum to make up for any loss or disadvantage suffered by that person in consequence of the discharge or modification; or

(ii) a sum to make up for any effect which the restriction had, at the time when it was imposed, in reducing the consideration then received for the land affected by it.

(1A) Subsection (1) (aa) above authorises the discharge or modification of a restriction by reference to its impeding some reasonable user of land in any case in which the Upper Tribunal is satisfied that the restriction, in impeding that user, either—

(a) does not secure to persons entitled to the benefit of it any practical benefits of substantial value or advantage to them; or

(b) is contrary to the public interest;

and that money will be an adequate compensation for the loss or disadvantage (if any) which any such person will suffer from the discharge or modification.

.....

(12) Where a term of more than forty years is created in land (whether before or after the commencement of this Act) this section shall, after the expiration of twenty-five years of the term, apply to restrictions affecting such leasehold land in like manner as it would have applied had the land been freehold:

Provided that this subsection shall not apply to mining leases."

its estate management policies to show that the maintenance of the covenant is a practical benefit of substantial value, or advantage, he must supply full, frank detailed evidence of his 'estate' to show why that is so. The landlord's failure to do that in *Berkeley Square*, was no doubt a strong factor against its defence.

In *Edgware Road*, the absence of a 'keep open' covenant meant that the user covenant was no more than an *indirect* way of the landlord managing its estate within the terms of its office policy, and so the user covenant did not secure directly R's wish to see the application land used as offices. The same was true in *Berkeley Square*.

One question which remains is whether in *Edgware Road* the tribunal was right in saying that while the proposed hotel use was a reasonable one, the application failed because 'the ability of {R} to exert control over this corner of the Estate through these restrictions is of significant benefit to them in the management of their interests'. Given the diversity of the Estate and the strategies R used to manage the various parts of that Estate it is curious that the tribunal found that the user covenant, which gave R control 'in this corner of the Estate' somehow secured a 'significant' benefit to R over the rest of its Estate. Even R's 'hotel strategy' did not apply to the proposal, and it might be said that the change of use proposed by A would not have a serious impact on R's 'office strategy'.

Practical suggestions which can be drawn from this decision

- In line with the principles set out in *Shaviram* and applied in *Berkeley Square* and *Edgware Road*, an applicant who is a tenant should face no *special* hurdles, when compared with an applicant who is a freeholder, in the determination of the application under s 84(1).
- Unless the landlord has no legal estate in land beyond the application property, it is not enough for the applicant to succeed by showing that the current user covenant retains the value of the reversion at £x and that it will not be substantially worth less than £x under the modification. What is important is to focus on the landlord's interest in neighbouring properties, or his 'estate' (where that exists) and to identify what might be the effect of the modification on the management and value of that estate. (It may be that the landlord might also be a tenant of other land affected by the proposed modification.) It seems that the main objection from the landlord in that position will usually be the fact that a modification will be 'the thin end of the wedge'. *Edgware Road* indicates that if the modification would weaken the ability to control the estate by the covenants in the leases, the tenant's application will fail. But that objection needs to be tested (by both sides) for unless there is a *real threat* that 'the precedent effect' will cause that weakening, the ability to control an estate by the covenant is not a practical benefit of substantial value, or advantage. It is a well-established principle in s 84(1) of the jurisdiction that each decision of the UTLC does not create a precedent. *Edgware Road* is troubling as it seems to contradict that principle.
- Finally, in the jurisdiction under s 84(1), the fate of each application turns on its own facts. The minute details of them matter. Whether or not the outcome in Edgware Road can be seen as 'right', it shows, with its recently born siblings, that applications by tenants within s 84(12) will present distinctive features and should not be overlooked. NLJ

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