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Drinks, Hospitality & Leisure

Dilapidations: Fighting Your Corner

A best practice guide

Our hospitality team specialises in advising pub companies, late night operators, restaurants, hotels and brewers. A specialist team means specialist advice from lawyers who understand the issues that you face.

Best practice guide: dilapidations

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When trying to exercise a break right or exit a site on lease expiry, the potential dilapidation liability is a particular worry for tenants. Especially in the current climate, landlords use this liability to discourage a tenant break or get the tenant to do works to ease the investment burden on the landlord or any incoming tenants.

It is worth saying that often any initial schedule of dilapidations served by the landlord will exaggerate the level of liability, and negotiating and settling such claims becomes a tactical battle.

The note below sets out the key rights and tactics a tenant should be aware of when faced with a dilapidations claim.

Pre-action protocol

Tenants should be aware that there is a legal pre-action Protocol which landlords should follow when making a terminal dilapidations claim. The intent behind this is to allow the parties to lay their cards on the table in an orderly fashion, and thereby increase the chances of claims being settled without recourse to expensive and time consuming Court litigation. Where Court litigation cannot be avoided, compliance with the Protocol supports the efficient management of any subsequent Court proceedings. Non-compliance with the Protocol can have adverse costs consequences for the defaulting party in any subsequent litigation.

The key features of the protocol are:

- A terminal schedule of dilapidations is sent to a tenant within 56 days after termination of the lease term. The terminal schedule must contain an endorsement by the tenant's surveyor that the works set out in the schedule are reasonably required to remedy the alleged breaches, and full account has been taken of the landlord's intentions for the property.
- After receiving the updated terminal schedule, the tenant's surveyor has 56 days within which to respond. This is usually done by way of comments against each individual item set out in the landlord's schedule.
- The surveyors instructed then meet within 28 days of the landlord's surveyor receiving the tenant surveyor's response. The purpose of the meeting is to discuss, on a without prejudice basis, the items claimed and the tenant surveyor's responses.

Defences available to a tenant

A tenant may have a number of defences to any dilapidations claim presented:

1. On an item by item basis the tenant's surveyor can attack both whether or not the alleged breaches are actually breaches of covenant, and also the quantum of the claim. If the item claimed is not a breach of covenant, then the tenant's surveyor inserts a nil value against the item claimed. Alternatively, if it seems that the item claimed is a breach of covenant, then the tenant surveyor may state that the work done can be done more cheaply, either as a consequence of reduced labour rates or material, or as a consequence of a different method of repair being used. Where works are genuinely required to the property as a consequence of breach of covenant, the tenant may want to do such works before the end of the term to stay in control of costs and mitigate potential liability.

2. The tenant may argue that the item of repair claimed does not actually remedy a disrepair, but rather is intended to improve the state or condition of the premises, perhaps as a scheme of refurbishment or for marketing purposes for the unit.

3. A legal defence under section 18 of the Landlord and Tenant Act 1927. This:

- places a cap on what the landlord can recover by limiting claims to the amount by which the value of the landlord's property interest has been reduced as a result of disrepair. So, for example, if the damage to the landlord's freehold interest at the termination date is £100,000, but the cost of repairs would be £250,000, then the landlord can only claim £100,000 in dilapidations;
- states the landlord cannot recover anything by way of dilapidations if shortly after termination of the lease the landlord intends to demolish the site or carry out such structural alterations which would render valueless any repairs carried out by the tenant.

Running a section 18 case to cap the claim for damages can be a very effective way of defending a terminal dilapidations claim. However it will require specialist legal and valuation advice.

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Timing and tactics

Terminal dilapidations can run on, and often it is in the tenant's interest to allow them to do so. In our experience there is a tendency for surveyors acting for landlords to grossly exaggerate a landlord's claim for negotiation purposes. For example, a £500,000 claim that we are dealing with at the moment is likely to settle at around £150,000 or so, and there are several £150,000 claims that we have defended in the last year or so which have ultimately resulted in a complete withdrawal by the landlord. However, a common factor in these claims, and successfully dealing with them, is that the passage of time will reveal a landlord's true intentions for the property, and during that passage of time the right strategic moves have to be made in defending the claim presented.

Points to watch out for

- If the landlord's claim is good, then a tenant is in principle liable to pay the landlord's costs. This position can in due course be switched if the tenant makes a good offer to settle, in a certain form (called a "Part 36 offer", named after a civil procedural rule which governs litigation), to the landlord which the landlord fails to accept and the tenant then later goes on to defeat the landlord in Court proceedings.
- If the landlord goes ahead and does works of repair to remedy breaches of covenant, then those works carried out can, on the face of it, be taken as evidence of the landlord's loss. It can be hard to rebut the costs of work actually done by a landlord, unless those works are not in fact remedial works or the cost of the works done is capped under s.18 as set out above.
- There may be works done or claimed by a landlord to remedy breaches of covenant other than repairing covenants, such as to reinstate the premises. These works will not be caught by the section 18 cap.

Beware

Dilapidations claims are extremely technical and strategic in nature, but our litigation team has extensive experience of both managing and supporting building surveyors and our clients to help them through the maze.

To find out how we can help you please contact our Drinks, Hospitality & Leisure specialists:

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