DEVELOPMENT LAND AND OVERAGE CLAUSES

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INTRODUCTORY REMARKS

Overage clauses are often intellectually challenging and frequently result in litigation – first as to their true meaning and effect and secondly, by the party disadvantaged by the court's decision on construction against the lawyers responsible for drafting.

Such clauses are in practice of one of two kinds: "positive overage clauses" i.e. an obligation on the part of the acquiring developer to make a payment to the original landowner which reflects some enhanced value of the site attributable (usually) to the grant of a planning permission; "negative overage clauses" i.e. a provision restricting the use to which land may be put by a developer without first making a payment to the original landowner.[1]

In the case of a "positive overage clause," the benefit of the "covenant to pay" is (generally) capable of assignment; the burden of the "covenant to pay" is generally secured by a variety of alternative measures: under the Rentcharges Act 1977, entry of restrictions on the register, use of a charge and of long leases along with "take options." "Negative overage clauses" are (generally) given effect by way of restrictive covenants.

SECURING THE BENEFIT OF OVERAGE CLAUSES

In practice, methods of securing the benefit of "overage clauses" trouble the courts less frequently than issues of construction in relation to the clause itself. Particular care is also required where "overage" becomes due in the context of participation in a land investment scheme.

[1] For a helpful discussion at a conceptual level see Development Land Overage and Clawback, Jessel [2001] Jordans.

In view of the above, this paper will concentrate on (1) construction issues and (2) "overage" and land investment schemes.

CONSTRUCTION OF OVERAGE CLAUSES

The definition of the "trigger event" is the most important aspect of drafting the "overage clause." Whilst usually most relevant to "positive overage clauses," the issue can assume importance in the context of "negative overage clauses."

Golden Grove Limited v Rausa Mumford (a firm)

A good example highlighting a number of relevant issues in this context is *Golden Grove Limited v Rausa Mumford (a firm)*.[2] This concerned a purchase of development land from inter alia British Rail which held the key to unlocking development of further land in the ownership of a third party.

The conveyance incorporated a complex series of covenants (secured by charges and proposed restrictions on the register) as follows. First, it was provided that in the event of any development of any part of the third party's "back land" which would benefit from access over the land being sold a payment would be due to British Rail representing a stipulated percentage of the "difference between the open market value of the relevant part [with the benefit of the development consent] and full access to the public highway and the open market value of such relevant part on the basis of its present use on the assumption that access to the public highway over the [land being sold] being no better than that subsisting at the date [of the conveyance]." The reason for this provision was that there was some argument that the "back land" may benefit from
some prescriptive right of access in any event.

[2] July 2002, unreported QBD

Secondly, the "overage payment" due was charged on the <u>whole</u> of the land sold to Golden Grove.

Thirdly, the conveyance included an obligation on the part of the purchaser "not to effect any dealing with the whole or part of the property … without first procuring that the transferee or lessee has given to the [vendor] … a covenant on the part of the buyer to observe and perform the covenants … contained in this [conveyance]."

The provisions were expressed to be operative for a period of 80 years. The "chargeable event" was defined to mean "the use of any part of the property within the [80 year] prescribed period for the purpose of access to or from a 'relevant part' [of the back land] to or from [the highway] following the carrying on of the material operation within the meaning of section 56 of the Town & Country Planning Act 1990 in implementation of the planning permission for the carrying out of any development on the relevant part."

The effect of the covenants, which was not properly explained to the purchaser was to make the development land for all practical purposes incapable of residential development. On analysis, it was clear that if (for example) the back land came to be developed by the construction of (say) 25 separate dwellings, each accessed over the land acquired by Golden Grove then an "overage payment" would become due in respect of each development of each relevant part. If the land acquired by Golden Grove was to be developed by the construction of (say) 100 houses, each property would become burdened with the joint and several obligation to pay "overage." Further, if the "back land" became further developed at a later date (e.g. by way of a shopping complex) then yet further "overage" would be due (assuming such development occurred within the prescribed period). The conveyance included a provision for arbitration in the event of disputes over valuation uplifts. This would be small comfort, however, to the hypothetical 100 individual plot owners.

In the events which happened, the difficulties were addressed by a lump sum payment to release the land from these onerous provisions. This formed the subject of the (successful) claim to damages against the defendant firm.

<u>Titanic Investments Limited, Godsal and Godsal v Macfarlanes (a firm)</u>

A further example of problems arising from the lack of attention to definition of the "trigger event" is *<u>Titanic Investments Limited, Godsal and Godsal v Macfarlanes (a firm)</u>*.[3] In that case Titanic Investments Limited and Mr Godsal owned separate but adjoining parcels of land over which Laing Homes Limited had options. In the event of the "take options" being exercised (as they were) Laing's became liable to pay a percentage of the increase in value attributable to the obtaining of a "satisfactory planning permission." This in turn depended upon the net developable area ("the NDA") within the landholding, the subject of the options. For all practical purposes the interests of Mr Godsal and Titanic Investments Limited were the same.

A dispute arose as to whether the NDA was 21.7 acres (as contended for by Laing Homes) or 23 acres as contended for by Titanic Investments/Mr Godsal. The 1.3 acre difference was significant because the "overage" due was to be calculated at the rate of 90% of £750,000 per acre. Negotiations, conducted through Macfarlanes, resulted in the following position being agreed (and reflected in a contract then drawn up): Lanes would pay £12.1m for the property "based on a net developable acreage of 21.7 acres. In addition, Laing will pay a sum at a rate of £382,500 per developable acre … for any additional developable acreage over and above 21.7 net developable acres *if Laing obtains detailed planning permission, pursuant to Laing's application for such increased acreage at the same time as it obtains detailed planning permission for 21.7 net developable acres pursuant to outline planning consent number 15555.* This additional sum will become payable in one event only i.e. on Laing's receipt of the detailed planning permission for the extra acreage. It will not apply to any subsequent provision. It will be entirely at Laing's discretion as to whether and when to apply for planning permission for any area in excess

[3] 3 December 1998, CA.

of the 21.7 acres …" At the date of this agreement the outline planning consent number 15555 had already been obtained.

The italicised text proposed by Laing's was not discussed by Macfarlanes with Titanic Investments or Mr Godsal. The effect was to limit any additional "overage" payable to a detailed consent obtained pursuant to the outline permission already granted i.e. if, on the additional 1.3 acres, Laing's applied for a different outline consent, no "overage" would become due. The failure to explain this consequence was held to have been negligent and damages were awarded to reflect the lost opportunity for <u>both</u> Titanic Investments and Mr Godsal to obtain better terms as to payment.

<u>Stephens & Stephens v Cannon & Cannon</u>

In addition to a clear definition of the "trigger event," drafting attention needs also to be paid to the definition of the matters to be taken into account in determining the sum payable. An example of unclear drafting, leading to litigation is afforded by *<u>Stephens & Stephens v Cannon & Cannon</u>*.[4] There, the buyers agreed to purchase land for £600,000 in Albury, Surrey. They further agreed to obtain planning permission to construct at least 1 dwelling on the site and to pay 50% of the then increase in value on any amount over £1m. Part of the original purchase price was funded by an advance from the Bank of Ireland.

The "overage clause" was the subject of amendment in a supplemental agreement which recited that it "should only take effect provided that the legal charge in favour of the Bank of Ireland … has been repaid in full and the entries in the charges register to both titles … have been cancelled and that the provision [for overage] … only applies to net proceeds of sale after the said charge has been discharged." The same supplemental agreement recited the buyers obligation to obtain planning permission in which event on sale of "the new dwelling[s] … for a combined sum in excess of £1m, the buyers shall pay to [the sellers] 50% of the amount in excess of £1m subject only to

[4] [2005] EWCA Civ 222.

the deduction therefrom of one half of the legal and estate agency fees incurred in connection with such sale."

These provisions raised an ambiguity as to whether the charge sum due to the bank should be taken into account in reducing the divisible surplus over £1m. At first instance, the judge held: yes. On appeal, the court determined: no. The buyers construction lacked commercial common-sense, it being apparent that they had taken the risk as to the build costs not exceeding £400,000 and it would be a illogical to treat the proportion of the original purchase price secured by the bank charge differently.

<u>Bridehall Estates Limitd v St George North London Limited</u>

On the same topic, mention may be made of *<u>Bridehall Estates Limited v St George North London Limited</u>*.[5] The "overage clause" in that case was linked to a particular formula for valuing flats to be constructed on the development site. The development permission which the buyer was to obtain was expressed to be for a "new primarily residential building comprising in aggregate approximately 60,963sq ft of net internal area and consisting of a unit on the ground floor and part first floor … for use within class A3 … and a mix of apartments of 54,505sq ft of net internal area (or thereabouts) for residential use together with associated car parking …"

The "overage clause" then provided: "on the sales of the residential units if the aggregate sale price … achieved exceeds £340 per square foot of the total net internal area of the residential units … [the buyer] shall pay a sum calculated at 35% of the amount by which the total sale price for the residential units exceeds £340 per square foot." The question which arose was whether the aggregate sale price should be discounted insofar as it included a payment for use of a garage. Noting that "the agreement was not well drafted on this point" Carnwath LJ allowed an appeal against a decision at first instance holding that the value of a car park should be deducted from the aggregate sale price figure <u>before</u> calculating the 35% adjustment.

[5] [2004] EWCA Civ 141.

The above decisions are helpful examples of avoidable pitfalls. Non-exhaustively, the following issues for consideration are identified:

(1) Is the "trigger event" to be the grant of outline consent, the grant of detailed permission, the implementation of development consent, any of the foregoing by the purchaser or any third party;

(2) Is the realisation of value to be determined by a valuation formula or on a cash received basis; if the latter, what provisions have been included to deal with possible disposals at an undervalue and/or part exchange and/or disposal on "tight terms" e.g. subject to a restrictive covenant affecting value and/or payment not in money e.g. by shares and/or where the price is artificial in that it reflects some "side deal."

ESTOPPEL AND RECTIFICATION

No or no adequate drafting of "overage clauses" creates the potential for significant financial loss – such that it is often worthwhile taxing the ingenuity of lawyers to seek remedies by recourse to non-mainstream bases of claim. Two recent examples relating to such clauses are *Yeomans' Row Management Limited v Cobbe*[6] and *George Wimpey UK Limited v V.I. Construction Limited*.[7]

Yeoman's Row Management Limited Mr Cobbe

In *Yeomans' Row Management Limited* Mr Cobbe, a very experienced property developer, reached an agreement "in principle" with Yeomans' Row Management Limited (Mrs Lisle-Mainwaring) that he would purchase a freehold block of flats in Knightsbridge, London from YRML for £12m; he would (as he did) seek to obtain planning permission for redevelopment into 6 townhouses (which he did at a claimed cost/outlay of c£200,000); he would carry out the development and then pay to YRML 50% of gross proceeds over

[6] [2006] EWCA Civ 1139.

£24m. Mr Cobbe having carried out his side of the bargain down to the point of obtaining development permission, Mrs Lisle-Mainwaring reneged on the agreement. Nothing was in writing.

Mr Cobbe's attempt (initially) to enforce the deal failed (for want of compliance with the requirements of the Law of Property (Miscellaneous Provisions) Act 1989). He succeeded, however, in claims based on proprietary estoppel and in restitution. The main argument concerned the scope of the relief which would be granted to satisfy his "equity."

The judge at first instance (ultimately upheld by the Court of Appeal) allowed him a lien over the property representing 50% of the increase in value referable to his effort in obtaining planning permission. The contention that it should be limited to the cost of his services and outlay was rejected. The case then went off for an inquiry as to the appropriate sum due.

<u>George Wimpey UK Limited Vic Limited</u>

In *<u>George Wimpey UK Limited</u>* VIC Limited sold land in Kent for approximately £2.6m with an "overage clause" which was to reflect the size of flats later constructed by Wimpey's on the site. The precise formula was the subject of negotiation between Mr Keteridge (for Wimpey's) and Mr Youens (for VIC). In proffering a revised formula, Mr Keteridge omitted one ingredient (the "+E" factor) which had the potential to benefit VIC by some £800,000. It was common ground that the omission was a mistake. Wimpey's sought rectification on the basis of a unilateral mistake, alleging that VIC "at a time which is not known to [Wimpey], [Wimpey] became aware of the [same] and unconscionably decided to take advantage of [it]."

At first instance the judge went completely overboard in finding Mr Youens and a director of VIC to have been "dishonest." This formed no part of the pleaded case. The judge, however, also held that if he was wrong as to that,

[7] [2005] EWCA Civ 77.

rectification should be ordered on the basis that it would be unconscionable for VIC to rely on the drafting error. In the Court of Appeal the order for rectification was overturned.

The decision is helpful in clarifying the ingredients to a claim for rectification on the basis of unilateral mistake. It is clear there are four elements: (1) a mistake on the part of party A in believing that a document contains a particular term which, mistakenly, is omitted; (2) that the other party B is aware of the omission and that it is due to a mistake by A; (3) that B has omitted to draw the mistake to the notice of A and (4) that the mistake is one calculated to benefit B. If these requirements are satisfied, the court <u>may</u> regard it as inequitable to allow B to resist rectification.

The essence of the entitlement, however, rests upon "inequitable" conduct by B in resisting rectification. Sedley LJ observed:

> "There is, as it seems to me, a paradox in the notion of what an honourable and reasonable person would do in the context of an arm's-length commercial negotiation. This is a context in which honour (or honesty) and rationality (or reasonableness) are frequently not on speaking terms … An honourable person negotiating for VIC would probably have asked Wimpey if they realised that E had been left out, but I very much doubt whether a reasonable negotiator would have done so. His first duty would have been to his own principal, whose interests undoubtedly lay in leaving E out and not alerting Wimpey to the omission. The phrase 'honest and reasonable' is not a term of art. It is a judicial attempt to sketch a line beyond which conduct may be regarded as unconscionable or inequitable. Its duality, however, is a recognition that honesty alone is too pure a standard for business dealings because it omits legitimate self interest; while reasonableness alone is capable of legitimising Machiavellian tactics."

<u>*LAND INVESTMENT SCHEMES*</u>

The purchase of land with development potential is often achieved through the use of a corporate (SPV[8]) vehicle where capital is provided by an allotment of shares. These will (usually) carry class rights to a dividend "overage" payment upon the happening of the "trigger event." Alternatively, funding may be put up by invitations to participate in a joint venture, partnership or loose "unincorporated association."

Advice upon and participation in these schemes must have an eye to the provisions of the Financial Services & Markets Act 2000. In particular, section 235(1) of the 2000 Act contains a definition of "collective investment schemes" as comprising "any arrangements with respect to collective property of any description … the purpose or effect of which is to enable persons taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income."

The reference to "property of any description" is apt to include therefore "land." Participation in a land investment scheme is usually with an eye to later participation in profit arising from the (at least) management or disposal of the subject matter i.e. receipt of "overage" on development.

To qualify as a collective investment scheme "the arrangements must be such that the persons who are to participate ("participants") do not have day to day control over the management of the property, whether or not they have the right to consult it or to give directions."[9] Further, "the arrangements must also have either or both of the following characteristics (a) the contributions of the participants and the profits or income out of which payments are to be made to them are pooled; (b) the property is managed as a whole by or on behalf of the operator of the scheme."[10]

[8] Special Purpose Vehicle
[9] s235(2), FSMA 2000.
[10] s235(3), FSMA 2000.

Units in a collective investment scheme are regulated investments.[11] Establishing, operating or winding-up a collective investment scheme is also a regulated activity.[12]

Care must accordingly be taken that authorisation is obtained (where required) for establishing/operating such a scheme and/or in respect of promoting and/or dealing in such investments. In this area the FSA has provided useful guidance in its perimeter guidance (PERG). In particular at PERG 11.3 the following example is given: "I run a business arranging for the sale of individual plots of development land to investors who are also required to use my services in obtaining planning permission for or disposing of the land as a whole (or both). Might I need to be authorised?"

The answer given is "Yes, this is likely to be the case. This will be because the role you have in obtaining planning permission or in negotiating and effecting the sale of the land (or both) may mean that you are operating a collective investment scheme … if the planning or disposal process is such that individual investors do not have day to day control over it, the arrangements are likely to amount to a collective investment scheme and to operate it you will need to be authorised or exempt."

Where the "overage" arrangement is, however, simply put in place for the benefit of adjoining landowners and/or as part of a genuine joint enterprise between connected purchasers then it will probably benefit from a generic exclusion from authorisation requirements contained in article 69 of the Regulated Activities Order. In this context, the details of each "scheme" would need to be carefully considered as the need for authorisation is very fact sensitive.

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[11] See article 81 of the Regulated Activities Order SI 2001/544 as amended.

[12] See article 51(1) of the Regulated Activities Order, supra.