OPTIONS & OVERAGE UPDATE

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Part 1 - Revision

Introduction

> *"The right to call for a conveyance of the land is an equitable interest or an equitable estate. In the ordinary course of a contract for purchase there is no doubt about this, and an option for repurchase is not different in its nature. A person exercising the option has to do two things, he has to give notice of his intention to purchase, and to pay the purchase money; but as far as the man who is liable to convey is concerned, his estate or interest is taken away from him without his consent, and the right to take it away being vested in another, the covenant giving the option must give the other an interest in land."*
>
> *London and South Western Railway Co v Gomm* (1882) 20 Ch.D. 562, 581
> per Sir George Jessel M.R.

> *"The option clause cannot be classified as a mere "agreement to make an agreement." There are not any terms left to be agreed between the parties. In modern terminology, it is to be classified as a unilateral or "if" contract. Although it creates from the outset a right on the part of the lessees, which they will be entitled, but not bound, to exercise against the lessors at a future date, it does not give rise to any legal obligations on the part of either party unless and until the lessees give notice in writing to the lessors, within the stipulated period, of their desire to purchase the freehold reversion to the lease. The giving of such notice, however, converts the "if" contract into a synallagmatic or bilateral contract, which creates mutual legal rights and obligations on the part of both lessors and lessees."*
>
> *Sudbrook Trading Estate Ltd v Eggleton* [1983] 1 AC 444, 476
> per Lord Diplock

Some Key Cases

Spiro v Glencrown Properties Ltd [1991] Ch. 537
s.2 of the LP(MP)A 1989 applies to the agreement which creates the option and not to the notice by which it is exercised

Active Estates Ltd v Parness [2002] 3 EGLR 13
s.2 LR(MP)A 1989 applied to document containing put option by which lessor could require lessee to take new lease (i.e. the lease) and no further compliance with s.2 was required

A2 Dominion Homes Ltd v Prince Evans Solicitors [2015] EWHC 2490 (Ch)
Unilateral notice in relation to agreement for lease also conferred priority on the lease when completed

Di Luca v Juraise (Springs) Ltd (2000) 79 P&CR 193 – time is of the essence in exercise for options to purchase

Chartbrook Ltd v Persimmon Homes Ltd [2009] UKHL 38; [2009] AC 1101 – how to construe an option (and contracts generally).

Grant of an Option

May be by deed

A simple contract must comply with LR(MP)A 1989 s.2: it must be in writing and signed by or on behalf of each party. s.2 applies only to the grant of the option; not its exercise: see *Spiro v Glencrown* (above)

Extension

Extension of an option can be in accordance with any machinery in the option. e.g. by notice

If there is a fresh agreement, compliance with s.2 is required; it may even amount to a fresh option

Drafting Points

Definition of the Property

An equitable interest can arise over the whole of the land which is subject to the option even if the actual part to be acquired on exercise cannot be identified at the date of grant and can only be identified later with a contractual mechanism or process, e.g. a third party: *Sainsbury's Supermarkets Ltd v Olympia Homes Ltd* [2006] 1 P&CR 17

Price

There is more than one way for fixing a price. Examples are as follows:

- Fixed price – this is permissible, but is unusual given movement in the markets
- Price to be agreed – there is risk of it being void for uncertainty
- By formula – most common

Two examples of formulae:

Smith v Royce Properties **Ltd** 19 November 2003 (unreported) Peter Smith J, Ch D

> "the then current use value of the land with vacant possession" referred to the use of the land at the time of the exercise of the option, which was agricultural, with development value being disregarded

Multi-Link Leisure Developments Ltd v North Lanarkshire Council [2010] UKSC 47

> "equal to the full market value of the subjects hereby let" allowed development hope value of the land to be taken into account

What if the machinery breaks, or contains a defect?

Sudbrook Trading Estate Ltd v Eggleton [1983] 1 AC 444

If the mode of ascertaining the price is subsidiary rather than an essential term of the contract, the court will intervene and supply or substitute its own machinery to carry out the main purpose of ascertaining the price so that the agreement can be carried out.

> *"[W]here an agreement is made to sell at a price to be fixed by a valuer who is named, or who, by reason of holding some office such as auditor of a company whose shares are to be valued, will have special knowledge relevant to the question of value, the prescribed mode may well be regarded as essential. Where, as here, the machinery consists of valuers and an umpire, none of whom is named or identified, it is in my opinion unrealistic to regard it as an essential term. If it breaks down there is no reason why the court should not substitute other machinery to carry out the main purpose of ascertaining the price in order that the agreement may be carried out."*
>
> Lord Fraser of Tullybelton at 484

What if there is no machinery?

Brown v Gould [1972] Ch 53

A lease contained an option for a further term at a rent "to be fixed having regard to the market value of the premises at the time of exercising the option taking into account to the advantage of the tenant any increased value of such premises attributable to structural improvements made by the tenant during the currency of the original term." No machinery for fixing the rent was provided. The tenant served notice to exercise the option, but the landlord contended that the clause was void for uncertainty.

Held: where no machinery is provided the court will make the valuation itself. Accordingly the option was validly exercised.

Options in Land Law

An option creates immediate equitable interest in the land, even if granted for nominal or zero consideration: *London and South Western Railway Co v Gomm* (1882) 20 Ch.D. 562 (see above)

That reasoning applies to conditional options where control of the condition is with the grantee, e.g. where the option is exercisable only if planning permission is granted for a particular development

> *"It makes no difference whether or not the contingency is within the sole power of the purchaser. The important point is that [the vendor's] estate or interest is taken away from him without his consent"*:
>
> ***Spiro v Glencrown Properties Ltd*** per Hoffman J at 544

Contrast that with the case where control is with the grantor, e.g. if the grantor fails to develop within a specified period. Power lies only with grantor, so the land is not taken away without his consent. That is not an option.

Land Registration

Registered Land

An option should immediately be made the subject of a unilateral notice under s.32-34 of LRA 2002. The effect of such notice is to preserve the priority of the option: s.29(2)

Failure to enter notice results in postponement of priority to interest under the disposition where there is a registrable disposition of a registered estate for valuable consideration: s.29(1)

But otherwise, the basic rule in s.28 provides that the priority of an interest affecting a registered estate is not affected by a disposition of the estate.

Unregistered Land

(1) – Apply for a caution against first registration under Part 2 of LRA 2002

(2) – An option is an estate contract for the purposes of s.2(4)(iv) of the Land Charges Act 1972. All forms of option must be registered as a class C(iv) land charge.

Failure to register renders the option void against a purchaser for money or money's worth of a legal estate in the land affected: ***Midland Bank Trust Co Ltd v Green*** [1981] AC 513

Exercise of Options

Jolley v Carmel [2000] 3 EGLR 68 – a contract for sale provided for completion conditional upon the purchaser obtaining planning permission but no express obligation on the purchaser to use reasonable endeavours to obtain it and no long-stop date. Held: there was no implied term that permission would be pursued and obtained within a reasonable time

"satisfactory planning permission" turns on construction of the contract. See e.g. ***Millers Wharf Partnership Ltd v Corinthian Column Ltd*** (1990) 61 P&CR 461

Timing of Exercise

Time is of the essence for options to purchase ***Hare v Nicholl*** [1966] 2 QV 130 confirmed in ***Di Luca v Juraise (Springs) Ltd*** (2000) 79 P&CR 193

Part 2 – Recent Developments

Watson v Watchfinder [2017] EWHC 1275 (Comm) [2017] Bus LR 1309

A share option agreement was entered into between C and D. Clause 3.1 of the agreement stated that "*the option may only be exercised with the consent of a majority of the board of directors of [D]*". C gave notice exercising the option and D responded that it had not and did not give its consent under clause 3.1. C sued for specific performance of the agreement.

Judge Waksman QC sitting as a judge of the High Court held:

(1) Clause 3.1 did not give D an unconditional right of veto. Such an interpretation would make the option meaningless if the grant was entirely within the gift of D. That construction defied common sense and was a commercial absurdity
(2) The exercise of the veto was subject to implied limits that it should not be exercised in a way which was arbitrary, capricious or irrational in the public law sense. See ***Braganza v BP Shipping*** [2015] 1 WLR 1661. There was a conflict of interest between directors of D who were existing shareholders because the grant of further shares would dilute their holdings. Fulfilment of the Braganza duty entailed a proper process for the decision including taking into account material points and not taking into account irrelevant considerations. It would also mean not reaching an outcome which was outside what any reasonable decision-maker could decide.
(3) The target of the duty was backwards-facing (concerned with past events) and involved considering whether C had made a real or significant contribution to the growth of D. One way in which that could be fulfilled would be the introduction of a significant investor by C.
(4) There had been no proper exercise of the discretion in clause 3.1. It was barely considered at one board meeting, very quickly and as a last item on the agenda. Some of the directors present did not even know who C was. Only one director gave evidence at trial. His evidence was that at the meeting he was under the impression that D had an absolute right of veto. That was echoed by D's refusal to provide any information about the board decision after the refusal of consent. There was no consideration at the board meeting of the introduction by C of an investor who had acquired a 15% holding in D.

Attorney General v River Dorée Holdings Limited (Saint Lucia) [2017] UKPC 39

A lease granted for 50 years from 24 October 1987 contained recital E which stated:

> The lessee at the end of the first ten year period of this Lease will be permitted … to purchase the then remainder of the land and buildings … provided the

> lessee has satisfactorily carried out the terms and conditions of this Lease including the Development Program for the sum of … EC$10 …

Clause 9(9) of the lease was as follows:

> At any time after the end of the tenth year of the term … the lessee may give notice in writing to the [landlord] of its desire to purchase the absolute ownership of the lands and buildings then subject to this Lease in which event subject to subclauses (10) (11) and (12) below [the landlord] will forthwith execute in favour of the lessee a deed of sale … so as to be consistent with the obligations of the lessee in this lease

Clauses 9(10)-(12) provided for the price of EC$10, the grant of a licence under the Aliens (Landholding Regulation) Laws and the lessee's liability for costs.

When the lessee sought to exercise the option, the landlord asserted that the lessee was in breach of the terms of the Development Program and was therefore precluded from acquiring absolute ownership. The lessee argued that the recital conflicted with clause 9(9) and that clause 9(9) should prevail.

The Privy Council held that clause 9(9) was clear as to the conditions under which the option was to be exercised. A recital may in appropriate circumstances serve as background or as introduction informing or assisting the interpretation of a substantive provision, but the two must be capable of being read consistently, which was not the case. No ambiguity can be created from a mere recital which cannot be read consistently with the substantive and operative parts of the contract. High authority dictates that preference must be give to a substantive provision over a recital: ***Mackenzie v The Duke of Devonshire*** [1896] AC 400.

Sparks v Biden [2017] EWHC 1994 (Ch) HHJ Davis-White QC

Mr. Sparks, who was close to retirement age, had over several years gradually assembled a development site in Wimbledon with a view to its development so as to provide him with a pension. He occupied part of the land for the purposes of a business. He did not have the expertise or the funds to develop the site himself and therefore set about finding a developer. In due course he selected Mr. Biden and entered into an option agreement with him. The proposed development was of about 8 new houses.

The option agreement was negotiated over many months by experienced solicitors acting on behalf of each party, and went through 23 iterations. It contained an option for Mr. Biden's company, Linkwood, to purchase the site of £600,000 together with overage. It required Linkwood during the 3 years from the date of the agreement to apply for planning permission and use all reasonable endeavours to obtain it. The option could be exercised within the same 3 year period. If the permission was issued within the 3 year period, the buyer had 1 month to exercise the option. If the option was exercised and the sale completed, the buyer was required to proceed as soon a practicable to construct the development in accordance with the permission.

Overage arose once any one of the new dwellings were sold. Mr. Sparks was entitled to one third of the sale price of each subject to two conditions. First, overage only arose in

regard to sale proceeds in excess of the purchase price of £600,000, so the buyer was not obliged to pay overage in relation to the first £1.8m of sales. Second, Mr. Sparks was entitled to a minimum payment of £700,000 in addition to the purchase price of 600,000. The obligation to pay overage depended on there being sales of the newly constructed dwellings. A sale was defined as a freehold or long leasehold sale. The agreement was extended by a supplemental agreement which also reduced the purchase price to £500,0000 and altered the overage provision to apply only in relation to sale proceeds in excess of £500,000. At the same time as the supplemental agreement, Linkwood assigned the benefit of the option to Mr. Biden who exercised the option.

Permission was granted for 8 houses which were in due course built. Instead of selling them, Mr. Biden let seven on assured shorthold tenancies and occupied the other. He said he was not obliged to sell any house unless and until he decided to do so, and he could indefinitely delay the obligation to pay overage. Mr. Sparks issued a claim in which he contended a term should be implied that Mr. Biden was under an obligation to market and sell each house within a reasonable time of the option having been exercised and planning permission having been obtained.

The judge found that such a term could be implied on the ground that it was necessary as a matter of business efficacy and that without it the agreement lacked practical or commercial coherence. The clause was so obvious that it went without saying.
The key factor pointing towards implication was the structure of the agreement by which (1) the buyer was placed under an obligation to use all reasonable endeavours during the option period to obtain planning permission (2) after completion of the purchase to proceed as soon as practicable to construct the development and (3) to pay overage in a minimum sum of £700,000. (1) and (2) were clearly premised on the basis that all reasonable efforts to carry out the development as soon as possible, and that must be with a view to realisation of the value of the development and from Mr. Sparks' perspective the entitlement to overage. Otherwise he would have no interest in imposing or enforcing those obligations. The correct term to imply was "within a reasonable period" rather than " as soon as reasonably practicable". The former permits a wide range of matters to be taken into account such as whether it reasonable to sell one house at a depressed price because the entire development was not yet complete, or reasonable to wait.

TCG Pubs Limited (in administration) v The Master and Wardens or Governors of the Art or Mystery of the Girdlers of London [2017] EWHC 772

C wished to assign the residue of a lease of a the Hop Poles pub dated 22 June 1987 to Stonegate Pub Company Limited as part of a pre-pack administration in which Stonegate had made an offer to buy the TCG group. Several properties were included in the overall deal, of which £1,700,000 was apportioned by Stonegate to the pub and £415,084 for associated chattels.

The relevant assignment clause in the lease was 3(12)(I) and it contained an option in the following terms:

> If [the tenants] wish to assign or sublet … the whole of the demised premises during the said term to any other party they must first grant an option to the Girdlers Company (such option to be exercised within sixty days of the date of

> receipt of notice by the Girdlers Company of application by [the tenants] to assign or sublet … the whole of the demised premises to such other party) to buy back the residue of the said term at the then current open market value of the demised premises such value to be agreed by the Girdlers Company and [the tenant] within two months of the Girdlers Company exercising such option or failing agreement within such time the same shall be determined by an independent valuer… acting as an exert … If such option is not exercised by the Girdlers Company as aforesaid [the tenants] may with the consent of the Girdlers Company such consent not to be unreasonably withheld or delayed assign or sublet the whole of the demised premises.

C's solicitors wrote a letter to the Girdlers seeking to trigger the landlord's buyback under the option. The material parts of the letter were:

> We refer to the lease dated 22 June 1987 …
>
> Clause 12(I) of the Lease provides that, prior to disposing of the Property, the tenant must grant an option to the landlord to buy back the residue of the term at the current open market value of the Property
>
> In accordance with this Clause, we have been instructed by the Administrator to offer you the ability to purchase the Property at a proposed prince of £1,700,000. The Administrators have received an offer of £1,700,000 for the Property which is considered to be the open market value of the Property. Under the terms of Clause 12(I), we require a response from you within 60 days of receipt of this notice…

The Girdlers took a number of points, of which two are of interest for this paper. Firstly, they said that the letter was not sufficient because it was not a proper formal option document. Secondly they said that it was defective in any event because it did not offer to sell at market value. Mann J held as follows:

(1) The lease must be construed against the legislative background at the time of the lease, which included s.40 of the LPA 1925, not s.2 of the LPA(MP)A 1989, which was not even on the horizon at the time. The wording used in the clause pointed towards a formal transaction rather than the giving of a notice. Other clauses in the lease required things to be done by notice. If the parties had intended a simpler mechanism it would not have been difficult to provide one, and the fact they did not pointed towards a formal option.
(2) The effect of s.2 of LR(MP)A 1989 was that both parties were required to sign the option because it was a contract for the disposition of an interest in land. The 1989 Act did not exonerate the tenant from having to proffer a formal option; nor did the landlord come under a duty to co-operate. Applying *Shebelle Enterprises Ltd v Hampstead Garden Suburb Trust Ltd* [2014] 2 P&CR 114 the answer is that the tenant should proffer the same option as before with an invitation to the landlord to execute it. If the landlord does so, the option has been granted and its mechanism is worked through. If the landlord declines to execute it then the tenant has done all it can and would be taken to have fulfilled its obligations under the clause. The tenant could then seek permission to assign and the landlord could not refuse on the ground that the option has not been granted.

(3) Applying the principles in ***Mannai v Eagle Star Ltd*** [1997] AC 749 a reasonable landlord recipient would treat it as a notice under the option clause notwithstanding the references to £1.7m and value. The wrong identification of the clause number was an obvious error, which was important context for the rest of the notice. The use of "In accordance with this clause" made it obvious that the tenant was seeking to invoke that clause, as did the reference to 60 days and the open market value of the lease. In the context of the letter the use of "proposed" tempered the "questionable" reference to the price and made it clear that the tenant was proposing a price and inviting the landlord to agree it. The landlord would know that it did not like the price it could invoke the valuation mechanism.

Gaia Ventures Limited v Abbeygate Helical (Leisure Plaza) Limited [2018] EWHC 118 (Ch)

An overage provision required D to use reasonable endeavours to negotiate and agree with other parties so as to achieve a site assembly condition by a longstop date. The obligation to use reasonable endeavours was not to do it "when convenient" or "at the time best suited to D; but *as soon as* reasonably practicable. D, by delaying everything it could, did not make reasonable endeavours to achieve as soon as reasonably practicable the site assembly condition. As a result, the trigger date would have fallen before the longstop date, but did not. C was entitled to damages equivalent to the amount of the overage payment of £1.4m.

Sovereign Property Holdings Limited v London & Ilford Homes Limited [2017] EWHC 1773 (Ch)

C claimed an overage payment from D on the grounds that all of the requirements of the overage agreement had been complied with including a grant of Prior Approval pursuant to the General Development Order for a change of use from offices to residential by the planning authority. D contended that it was not liable because it was impossible to implement the proposal to which the local authority had given approval because the fire safety requirements of the Building Regulations could not be satisfied. The proposal would have removed one of the staircases, making it impossible to comply with fire regulations.

Warren J held (on C's application for summary judgment) that:

(1) D signed a contract which envisaged C making precisely the application which it did make and obtaining precisely a Prior Approval which the parties envisaged. D had the plan and executed the agreement knowing that the plan would form the basis of the application for Prior Approval.
(2) The definition of the trigger event in the agreement referred to "Residential Units shown on the plans at Annexure 3" which included the plan.
(3) It was incumbent on D to satisfy itself how the Building Regulations might impinge on the development.

C was therefore granted summary judgment. An appeal to the Court of Appeal is pending.

Burrows Investments Ltd v Ward Homes Ltd [2017] EWCA Civ 1577; [2018] 1 P&CR 13

C sold development land to D which was subject to an overage provision. D covenanted not to make any disposal other than a Permitted Disposal at any time during the Overage Period without either making certain payments or obtaining a deed of covenant from the purchaser. Permitted Disposal was defined to include:

> (c) the transfer/dedication/lease of land for the site of an electricity sub-station gas governor kiosk sewage pumping station and the like or for roads footpaths public open space or other social/community purposes

Following the agreement, a new planning permission was granted which permitted more units to be built, but also required by way of a s.106 agreement provision of 5 affordable units to a private registered provider of social housing. D then sold the completed affordable units to such a provider without informing C. C sued D for damages but lost at trial on the ground that the disposal of the 5 units was a Permitted Disposal within clause (c). C appealed to the Court of Appeal which allowed the appeal for the following reasons:

(1) It would be very strange to describe the transfer of a completed dwelling as a transfer of land, particulars when regard is had to the instances of transfers of land which are itemised in para (c). Land which is transferred for the site of an electricity sub-station etc. is unlikely to have any buildings on it at the date of transfer and will certainly not have a dwelling house on it. That is the essential point of the *ejusdem generis* argument. The words "or other social/community purposes" have to be read in the light of the specified purposes which precede them.

(2) The consequence of the proposed transfer to the registered provider not being a Permitted Disposal was that D needed to negotiate with C for release, which it had initially done. C was therefore entitled to damages on a negotiating (*Wrotham Park*) basis.

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