# Development Disputes

Current issues for property litigators

## The changing face of overage

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## Introduction

> *"Overage changed from being a promise of a spot of "jam tomorrow" for landowners, to being a means of deferring payment for developers, and a way of not only sharing reward but risk as well… In the current challenging market conditions, contractual structures are becoming increasingly sophisticated, with many morphing into joint venture arrangements."*[1]

Overage[2] used to be thought of as a 'bolt on' to a development agreement; a little something extra for the seller should the value of the site increase significantly in the future. In these changed economic times, however, overage is moving from the wings to centre stage. Overage agreements are now frequently used as a method to fund developments (with the seller taking significantly less up front in return for overage rights in the future), as part of a more collaborative enterprise between the seller and the developer.

This increasing importance of overage is reflected in a growing willingness of the Courts to look behind the letter of an overage agreement to the commercial purpose, and interpret it accordingly. This article examines that apparent trend. In particular, four interpretive approaches applied in the overage context in recent years to ensure the legal outcome reflects the commercial deal are considered. It is hoped that this analysis will assist those faced with an overage agreement which does not properly cater for the circumstances which have arisen, and will give them weapons with which to fight their corner in any ensuing dispute. There are, of course, other methods of dealing with such a problem, including rectification and estoppel by convention. This article focuses solely on the interpretive methods available.

As with all discussions of overage agreements, this analysis comes with a number of care warnings. Overage disputes are very fact-specific and overage agreements vary widely. Decided cases are useful in spotting general trends and attitudes and in articulating principles and approaches, but it will always be necessary to apply those principles to the facts of the particular case. In addition, it is not the purpose of this article to define overage, to advise on the drafting of overage provisions or compare the various methods by which overage can be secured against a subsequent disposal of the land.[3]

In this article, the terms 'seller' and 'developer' will be used to identify the parties most frequently found on opposite sides of these types of agreements. The agreements themselves will be described as 'overage agreements', the standard form of which is a sale of land by the seller to the developer, with a contractual provision for potential future payments to the seller on a 'trigger event' such as unit sales by the developer exceeding a certain value.

## The problem with overage

The challenges inherent in drafting overage agreements are well documented and familiar to practitioners in this area. Overage agreements may be designed to last for decades, and with this longevity comes the problem of providing for all possible contingencies. Defining a suitable 'trigger event' can be difficult; likewise identifying the person or persons to whom the overage provision is

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1 Tomlinson and Leonard (2012), The Age of Overage, EG 2012, 1210, 80-82.

2 "Overage" is the term used to describe the contractual entitlement enjoyed by a vendor or landowner to receive additional payment from a developer upon the future happening of a certain trigger event, typically an increase in the land value by reason of the obtaining of planning permission, or the receipt of higher than anticipated sales revenues.

3 Readers interested in these topics should consult Jessel, C. (2007), Development Land, Overage and Clawback (2nd edn.).

intended to apply.[4] When overage comes to be paid, it is often in very different circumstances to those prevailing when the overage agreement was made, leading to disputes between sellers and developers over the meaning of payment obligations.

Even with the best will (and brain) in the world, an overage agreement cannot possibly provide for every potential contingency and problem. Consider *Hildron Finance Ltd v Sunley Holdings Ltd*.[5] In that case, the Court decided that when the freehold in the block (including the porter's apartment) was sold to the qualifying tenants following the collective enfranchisement procedure, the seller was not entitled to share in the ensuing payment made to the buyer. Could those drafting an overage agreement in 1986 in relation to a potential future sale of a porter's apartment in a large block of flats have foreseen the collective enfranchisement provisions in Part I of the Leasehold Reform, Housing and Urban Development Act 1993? The Judge concluded that transfer of the porter's apartment in those circumstances was *"well outside the contemplation of the parties in 1986"*, and the differences between what the agreement had contemplated and what in fact had happened were *"so many and so significant that it is impossible to impute a common intention to the parties that the [agreement] should be modified so as to accommodate them…"*.[6]

When problems of this type are encountered long after the agreement has been reached, it is easy to look back with the benefit of hindsight and identify what the drafter should have done differently, but that will usually be a sterile exercise. The property litigator will need to consider what methods the Courts will apply in order to advise on the effect of the agreement.

## Construction of the contract to give effect to the overage bargain

The first mechanism used by the Courts to help ensure overage agreements reflect the underlying commercial bargain is purposive interpretation. The trend towards more purposive contractual construction is well documented and affects all contracts, not just overage agreements. Nonetheless, in recent years the Courts have displayed particular willingness to adopt a (sometimes very) purposive contractual construction in order to ensure that an overage agreement operates to reflect the commercial deal struck by the parties.

The relaxation of judicial attitudes in this regard can be demonstrated by considering a 2002 case, as contrasted with more recent decisions. In *Ministry of Defence v Country & Metropolitan Homes*,[7] the Court had to consider the following facts. The Ministry of Defence sold an old RAF base to a developer, with the intention that the base (which included a number of existing buildings) would be redeveloped as a small rural community. There was a provision for overage to be paid if planning permission was granted and acted upon or the land was sold. There was also a 'get out' clause for the developer (Clause 5.13.6), enabling it to develop a major part of the base without paying any overage. That clause provided as follows:

> *"IT IS HEREBY AGREED AND DECLARED that following demolition of the buildings on [the brown land] [the hatched land] shall forthwith be released from the Overage Payments and the parties hereto shall do all necessary acts to complete all documentation as may be necessary to release such land from the Overage Payments."*

4 Quite apart from the challenges identified by Joanne Wicks QC in ensuring that provisions continue to bind the land, in her article in this book *Development Contracts and the Privity Trap*.

5 [2010] EWHC 1681 (Ch), [2010] 3 EGLR 1

6 [2010] EWHC 1681 (Ch), [2010] 3 EGLR 1, per Henderson J at [38]

7 [2002] EWHC 2113 (Ch), [2002] 44 EG 170

The idea was for the brown land to be open space; the price of the right to build overage-free houses on the hatched land was the demolition of the 37 houses on the brown land.[8] In the event, 35 out of the 37 buildings on the brown land were demolished. The final two were converted into a shop so as to comply with a requirement imposed by the planning authorities. Rimer J decided that the 'get out' clause did not apply and that overage was payable, and also refused to rectify the contract. This was despite the fact that there was evidence as part of a claim for rectification that the Ministry of Defence would have been happy to agree to a proviso for retaining a building on the brown land if that was sought by the planning authority.[9] The Judge's decision involved a finding that it would have been open to the developers to demolish the 37 buildings on the brown land and rebuild them, and still take the benefit of the 'get out' clause, a scheme which one of witnesses described as *"barmy"*. [10] Despite these oddities, Rimer J determined that overage remained payable.

> *"[Counsel for the developer] also says that to construe clause 5.13.6 according to the ordinary meaning of the parties' language is to attribute to them an improbable and unbusinesslike intention. This does not persuade me either. It is quite possible that, had the parties foreseen a planning condition requiring the village shop to be on the brown land, they would have made some provision for this in clause 5.13.6. But they did not foresee it, they did not so provide, and there is no basis on which the court can now engage in a rewriting of their contract so as make some such provision…"*[11]

Contrast the 2008 case of *Micro Design Group Ltd and Another v BDW Trading Ltd*.[12] In that case, a deed of overage provided for various payments on certain trigger events, including *"the grant of an Improved Planning Permission"*. The deed did not restrict who could apply for 'Improved Planning Permission', and in the event the seller applied, thus (it asserted) triggering the overage payment. The Court of Appeal decided that, as a matter of construction, overage could only be triggered by planning consent granted on the application of the buyer/developer. There were pointers within the deed itself, but the Court also relied on the commercial bargain that had been struck between the parties.

> *"… there is also an argument that supports this construction based upon the commercial purpose of the agreement…It is accepted on behalf of the seller that their contention involves, at a very minimum, its ability to obtain a payment if it obtains planning permission which the buyer has not sought and which the buyer does not want. The commercial argument has to be looked at simply in relation to that example. It seems to me clear that no person would enter into an agreement to buy development land with planning permission and then give the seller the right after completion to obtain further payments by seeking and obtaining planning permission itself which the buyer might not want. Once the land was transferred it was the buyer who alone would determine whether any further planning permission on the land it had bought was required. It would make no sense to give the right to do that to the person who had disposed of the land to a person who had bought it to develop it in the way in which it wanted to do it."*[13]

The comparison between the 2002 case of *Ministry of Defence v Country & Metropolitan Homes and Micro Design Group Ltd & Another v BDW Trading Ltd* does not show stark change in judicial

8 Ibid at [15]
9 Ibid at [35]
10 Ibid at [29]
11 Ibid at [31]
12 [2008] EWCA Civ 448
13 [2008] EWCA Civ 448 at [21]-[22] per Thomas LJ

attitudes, but it does demonstrate an increased willingness to look beyond the contractual wording (even if that wording is clear) to ensure the overage agreement works to reflect the bargain struck.

*Chartbrook Ltd and Another v Persimmon Homes Ltd and Another,*[14] continued this trend. In the overage agreement in *Chartbrook*, the seller was to receive an agreed price broken down into total land value and a 'balancing payment', defined as:

> *"23.4% of the price achieved for each residential unit in excess of the minimum guaranteed residential unit value [MGRUV] less the costs and incentives."*

This clause was subject to two possible meanings, the overall difference in price between which was over £3.5 million pounds.

- 23.4% of [net price – MGRUV]; or
- [23.4% of net price] – [MGRUV].

The second construction was commercially more sensible: it provided for an overage payment if the unit sold for significantly more than the anticipated sale price, whereas on the first construction a very large additional payment would inevitably arise even if the market fell significantly in the interim. The High Court (Briggs J) and the Court of Appeal, by majority, preferred the first construction. The House of Lords recognised that the first construction followed the ordinary rules of syntax but nonetheless preferred the second. This second interpretation required quite significant rearranging of the clause. Lord Hoffman indicated this did not matter.

> *"I do not think that it is necessary to undertake the exercise of comparing this language with that of the definition in order to see how much use of red ink is involved. When the language used in an instrument gives rise to difficulties of construction, the process of interpretation does not require one to formulate some alternative form of words which approximates as closely as possible to that of the parties. It is to decide what a reasonable person would have understood the parties to have meant by using the language which they did. The fact that the court might have to express that meaning in language quite different from that used by the parties … is no reason for not giving effect to what they appear to have meant….*
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> *What is clear from these cases is that there is not, so to speak, a limit to the amount of red ink or verbal rearrangement or correction which the court is allowed. All that is required is that it should be clear that something has gone wrong with the language and that it should be clear what a reasonable person would have understood the parties to have meant. In my opinion, both of these requirements are satisfied."*[15]

As with *Micro Design*, there were a number of pointers in the overage agreement in support of their Lordships' interpretation. Lord Walker also, however, confirmed that this purposive approach to interpretation of this overage agreement was justified to ensure it reflected the general structure of the bargain struck between the parties.[16]

14 [2009] UKHL 38, [2009] 1 AC 1101
15 [2009] UKHL 38, [2009] 1 AC 1101 at [21] and [25]
16 [2009] UKHL 38, [2009] 1 AC 1101 at [95]

## Implied terms

The next three mechanisms considered are all species of implied terms. Terms can be implied into a contract either in law or in fact. Terms implied in law apply to specific categories of contract (e.g. tenancies, contracts of employment). They are a method of regulating such contracts and their recognition depends, to a large extent, on policy considerations.[17] For terms implied in fact, the test is whether the term would spell out in express words what the contract, read against the relevant background, would reasonably be understood to mean.[18] The implied terms at issue here are all terms implied in fact, although some are of a more general nature than others.

## Implied duty of good faith

For a long time many practitioners considered duties of good faith to be of limited utility. Practitioners today would be unwise to overlook them.[19] The inclusion of an express or implied duty of good faith in an overage agreement in accordance with the principles below will provide one mechanism to help the agreement properly reflect the commercial deal made between the parties. Such terms are of particular importance in the modern, joint venture-type overage agreement between seller and developer.

Consider an overage agreement with the following features:

> *"…obligations of mutual cooperation in relation to the maximisation of the value of the [land] by the obtaining of planning permission and vacant possession, obligations of the [developer] to consult with and obtain the approval of the [seller] in relation to the Scheme and to the planning application, and an obligation to obtain the best value and/or the lowest cost in incurring expenditure in connection with the Scheme in circumstances where that expenditure was to constitute a deduction against the amount payable to the [seller] as its share of the Overage."*[20]

Such features are common in many modern overage agreements. The above extract describes the overage agreement in *Ross River Limited, Blue River LP v Cambridge City Football Club Limited*.[21] Briggs J went on to hold that, as a result of this relatively standard contractual set-up, the parties owed each other implied obligations of good faith.

> *"In my judgment the project for the realisation of the development value of the [land] constituted by the mutual obligations of the [seller] and [the developer] set out in the Sale Agreements had enough about it in the nature of a joint venture to require the parties to conduct themselves with mutual good faith…"*[22]

The Judge decided that there had been a breach of this obligation by the developer Ross River, in misleading the seller, Cambridge FC, as to the potential value of the development during negotiations for a buy-out of Cambridge FC's overage rights.

*Ross River* is undoubtedly an unusual case, involving as it did findings of bribery and fraudulent

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17 See Chitty on Contracts, 30th Edition, at 13-003.

18 *Attorney General of Belize and others v Belize Telecom Ltd* and another [2009] UKPC 10, [2009] 1 WLR 1988 at [16]-[27]

19 See Julian Greenhill's article in this book, *"Good Faith" Clauses in Development Agreements*.

20 [2007] EWHC 2115, [2008] 1 All ER 1004 at [69]

21 [2007] EWHC 2115, [2008] 1 All ER 1004. Permission to appeal (sought by both sides) was refused by the Court of Appeal: [2008] EWCA Civ 772.

22 [2007] EWHC 2115, [2008] 1 All ER 1004 at [229]

misrepresentation. Nonetheless, as stated above, the overage agreement in issue was relatively standard, and it is the finding of mutual obligations of good faith that is the most interesting aspect for present purposes.

The practical impact of such an implied obligation of good faith in an overage agreement could be significant. If, for example, the trigger event was the sale of the final unit in a development, an implied duty of good faith may prevent the developer from refusing to sell that final unit in an effort to avoid the overage payment.[23] Similarly, the implied duty of good faith may be used to prevent the developer submitting a 'dummy' planning permission application designed to trigger a lesser overage payment, and then proceeding to apply again for more valuable planning consent. On the other side of the transaction, a duty of good faith may prevent sellers from using the strict contractual wording to extract an overage payment in circumstances where such a payment was not intended. The terms of the overage agreement and the factual context will of course be of paramount importance, but if circumstances are suitable for an implied good faith obligation, such an obligation could have real teeth.

So when will a duty of good faith be implied in an overage agreement? The High Court in *Ross River* confirmed that there was no hard and fast rule, but the following guiding principles and pointers can be discerned from Briggs J's judgment:[24]

- The terms of the overage agreement are of primary importance.
- An implied duty of good faith is not lightly imposed, and is unlikely to be found if the contract itself regulates e.g. the parties' disclosure obligations.
- Duties of good faith are more likely to be implied in an overage agreement having *"enough about it in the nature of a joint venture"*.[25]

The key factors in *Ross River* pointing towards an implied duty of good faith are likely to arise in many modern day overage agreements. These include: (1) the fact that the project was to be carried out for the parties' mutual benefit, as sharers in the anticipated profit and, to an extent, costs (as these were to be deducted before distribution of profits); and (2) the fact that the agreement imposed on the developer obligations to obtain best value and minimise costs. In these circumstances, an implied duty of good faith was found to exist even though there was an express declaration against a partnership in the sale agreement.

## Implied duty of disclosure

Another method that may be used by the Courts to ensure the overage agreement operates according to the parties' commercial purpose is to imply a duty of disclosure.

The utility of an implied duty of disclosure depends on the nature of the overage provision. In modern joint venture-type overage agreements, such a duty could be of real importance. Often, the information relevant to determining the amount of the overage payment due to the seller will be within the exclusive knowledge of the developer. For example, the developer (but not the seller) may know the likelihood and scale of the potential development, the various development costs which will usually stand to be deducted as part of the calculation of overage, the progress of negotiations with various public bodies and their attitudes to the development. Depending on the formula adopted to

23 See the discussion of *Renewal Leeds Limited v Lowry Properties Limited* [2010] EWHC 2902, below, where an implied term was used to prevent the developer avoiding his overage obligations in such a scenario.

24 [2007] EWHC 2115, [2008] 1 All ER 1004 at [196]-[199], [229]-[232]

25 Ibid at [229]

calculate the overage payment due, an understanding of such matters may be key in ensuring that the seller is paid the appropriate amount. An implied duty of disclosure could also be of significant utility in enabling the seller to retain a measure of control over the development, and thus to ensure that the developer does all within its power to maximise the overage payable. In these scenarios, an implied duty of disclosure could have significant advantages for the seller.

Duties of good faith and disclosure are closely aligned (indeed, the former will ordinarily be treated as including the latter[26]), and the tests for their implication in an overage provision are likely to be similar. Factors likely to be of particular importance in implying disclosure duties, in addition to those considered above in relation to good faith, include the following.

- Whether there are any express obligations of disclosure. An express disclosure regime will militate strongly against a general implied duty of disclosure.

- Whether the means of knowledge of the facts needed to ensure the proper operation of the overage agreement are controlled by one party.

It is implicit in Briggs J's judgment in *Ross River* that a duty of disclosure would have been implied in that case were it not for the detailed disclosure obligations expressly contained in the sale agreement.

## Other terms implied to give effect to the overage bargain

The implied duties of good faith and of disclosure are just two specific instances of terms being implied "in fact" into overage agreements. Other terms can be implied into overage agreements by applying the usual principles of implication i.e. whether the provision would spell out in express words what the overage agreement, read against the relevant background, would reasonably be understood to mean.[27]

In *Renewal Leeds Limited v Lowry Properties Limited*,[28] the overage agreement provided for an additional payment to the seller if the developer achieved an increase over and above its anticipated sales revenue, to become payable *"not later than 20 working days after completion of the final sale of a completed residential unit".* The developer obtained planning permission for, and built, 84 houses. 80 of those houses were sold, with the total sales revenue significantly exceeding expectations. The developer left four houses incomplete and marketed them at above the market value so that they did not sell. The sellers themselves offered to buy the final four houses in order to trigger the overage payment, but the developer refused.

There was no express obligation in the overage agreement requiring the developer to build or sell the final residential unit, or indeed any unit. Nonetheless, in another clear example of the Courts interpreting the overage agreement to reflect the commercial bargain reached, Anthony Elleray QC (sitting as a deputy Judge of the High Court) implied a term that the developer must sell out the development in order to trigger the overage payment.[29]

> *"Were the parties to have addressed the question as to whether the [developer] could proceed with the residential development but then suspend or abort the final*

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26 See Julian Greenhill's article in this book, *"Good Faith" Clauses in Development Agreements*.

27 *Attorney General of Belize v Belize Telecom Limited* [2009] UKPC 10, [2009] 1 WLR 1988 at [16]-[27]

28 [2010] EWHC 2902. This decision is unreported and the official transcript unavailable from the major online providers. Should the reader wish to obtain a copy of the official transcript, he or she should not hesitate to email the writer at emurphy@wilberforce.co.uk.

29 A similar result could arguably have been achieved via an implied duty of good faith.

> *sales of units so that Overage would not arise, in my view the officious bystander would have said, — Of course not…Overage in this case has had to be calculated in relation to revenue from all the housing units and the anticipation, in my judgment, was that the [developer's] profits would come from the sale of all units and not from the sale of all units but one (or four) of them. In other words the anticipation was that the [developer's] profit would be net of Overage and not beefed up by avoiding the mechanism for payment of Overage by suspending the final sale or by sterilising the final residential unit or units perhaps forever…*
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> *… The reasonable addressee would understand the contract to mean that if the development were carried out the [developer] would complete and sell out and would not sterilise the last unit so as to prevent the payment of Overage and the commercial purpose of the Overage provisions…"*[30]

A more recent example is the Supreme Court case of *Aberdeen City Council v Stewart Milne Group Ltd*.[31] This concerned a contract governed by Scots law, but the relevant principles of contractual construction applied are the same as those applied in England and Wales.

This case concerned a contract for the sale of land by Aberdeen City Council with a view to its development for business/industrial purposes. There was a fixed price, with a possible uplift payable to the Council on one of three events: a buy-out of the Council's overage rights; a lease of the land by the developer; or an outright sale of the land. Both in relation to a buy-out of the Council's overage rights or in relation to a lease, the agreement provided a formula for calculating the overage using the open market value of the property. No such formula was prescribed in the case of a sale of the property.

The developer sold the property to another company within the same group at below market value. The developer asserted that the overage provisions had thus been triggered, but no overage was payable once 'Allowable Costs' were taken into account.

Lord Clarke and Lord Hope (with whom the other law lords agreed) found that a term could be implied to the effect that, in the event of a sale which was not at arm's length in the open market, an open market valuation should be used to arrive at the base figure for the calculation of the profit share.

Lord Clarke said at paragraph 32:

> *"In this regard I entirely agree with Lord Hope's conclusions at para 22 above. As he puts it, the context shows that the parties must be taken to have intended that the base figure for the calculation of the uplift was to be the open market value of the subjects at the date of the event that triggered the obligation. In other words, it can be assumed that this is what the parties would have said if they had been asked about it at the time when the missives were entered into. The parties expressly agreed that in the case of a buy out or lease the profit would be arrived at by reference to market value. Rather like counsel for the respondent bank in Rainy Sky, Mr Craig Connal QC was not able to advance any commercially sensible argument as to why the parties would have agreed a different approach in the event of an on sale. I have no doubt that he would have done so if he had been*

30 [2010] EWHC 2902 at [37] and [40]
31 [2011] UKSC 56, [2010] 50 EG 58

> *able to think of one. As Lord Hope says at para 17, on the appellants' approach, it would be open to them to avoid the provisions relating to the open market value of a lease by selling the subjects to an associate company at an undervalue and arranging for the lease to be entered into by that company. The parties could not sensibly have intended such a result."*[32]

The mechanism of the implied term, like the duty of good faith, can have a significant impact on an overage agreement. *Renewal Leeds v Lowry* demonstrates that, in the right circumstances, an implied term can prevent one party wriggling out of its overage obligations. Similarly, *Aberdeen City Council v Stewart Milne Group Ltd* shows that an implied term can prevent a developer from exploiting the strict wording of the overage agreement to trigger a lesser payment to the seller than the parties' bargain contemplated.

## Conclusion

While each overage agreement will turn on its own wording, the cases examined in this article appear to demonstrate a shift in judicial attitudes to overage, and a willingness to try and make the overage agreement 'fit' with the underlying deal struck, even where the agreement fails to provide for the circumstance that has occurred (as in *Aberdeen*) or provides for something the parties cannot have intended (as in *Chartbrook*). The reasons for this willingness (whether consciously or unconsciously) no doubt include the increased role overage plays in land development in the recession and beyond, allowing developers to spread the cost and risk of bringing a building scheme to life. The mechanisms examined in this article can only be employed so far, but they do provide some practical tools to help make written overage agreements yield to the bargain struck between seller and developer.

32 [2011] UKSC 56, [2010] 50 EG 58 at [32]