Stokes v. Cambridge: What does it say? How does it help?

John Furber QC

A ransom strip is an area of land which provides the key to unlock the development potential of adjacent land by, for example, enabling a satisfactory access to be provided. How is such a ransom strip - often only a small area - to be valued? The question may arise in many different circumstances, including the compulsory purchase of the ransom strip and/or the adjacent land. The following answer is often given: "one-third of the increase in value of the adjacent land provided by the ransom strip" and then, by way of support, "Stokes v. Cambridge". Is that in itself an accurate or satisfactory answer?

Stokes v. Cambridge Corporation (1961) 13 P & CR 77 is a decision of two chartered surveyors sitting as members of the Lands Tribunal, relating to the valuation of 12.6 acres of farm land in Cambridge, acquired by the Corporation by compulsory purchase. It was agreed that planning permission for industrial development must be assumed, subject to conditions requiring satisfactory access to the land and provision of estate roads. The land which could provide satisfactory access was a track with an area of 0.7 acres, owned by the Corporation, primarily designed as "statutory allotments". The cost of acquiring this track (the "brown strip"), to enable development of the subject land, was a major issue before the Lands Tribunal. An important part of the background to the valuation was the Corporation's ownership of other land also designated as allotments ("the green and purple land"); this land also had some potential for industrial development which might be increased by the industrial development of the adjacent subject land.

The crucial passage setting out the reasoning of the Tribunal is as follows (p. 91):

"The value we have to determine is that of the subject land in the open market at the date of service of the notice to treat, subject to the statutory considerations. That value largely depends upon the price a prospective purchaser at that date would have expected to pay for access. There are thus two hypothetical transactions, one depending upon the other. The primary transaction is the purchase of the subject land itself; the secondary transaction, without which the primary transaction cannot fructify, is the purchase of the brown land. It is implicit in the rules under the 1919 Act [1] that in relation to the primary transaction the identity, resources or motives of any particular vendor or purchaser must be ignored; the value to be determined is the value in the market. But there is no market for this access, except to a prospective developer of the subject land.

We hold that we should be wrong in law to pay any regard to the fact that the Corporation, who are at once the acquiring authority and the town planning authority, own the brown strip [2]. Apart from that, we consider we are entitled - indeed, we are required - to view the actualities through the eyes of a prospective purchaser of the subject land at the material time: to note that the owner of the brown strip is also the owner of the green and purple land; that planning is fluid and open to review from time to time; that at some future date the green and purple land, now allocated to allotments, may be rezoned for industry - as has already happened elsewhere in Cambridge; that the likelihood of such rezoning will be increased if the subject land is redeveloped for industry first; that accordingly there is an inducement to the owner of the brown strip to sell it as access in order to expedite, in his own interests, this sequence of events.

In the light of all these considerations we think a prospective purchaser of the subject land would be more optimistic about the price he would be obliged to pay for access than is the district valuer. The exact proportion of the eventual profit he would expect to pay away is a matter for conjecture, but in all the circumstances we think a half is too much [3]*; we shall substitute one-third on the basis that the Corporation would not contribute to the cost of road making".*

Following this reasoning the members of the Tribunal set out the calculation of their award. They determined the value of the subject land, deferred for three years, for sale for industrial development in plots, as £68,208 (£7,000 per acre) from which they first deducted a developer's profit of 15% (an allowance "which in our opinion would be academically correct" - p. 83) and then deducted a further sum for "estimated costs of roads, sewers, fencing, consents and contingencies". This took them to the "value of the land with necessary access for industrial development" as being £33,753, and they then deducted the existing use value of £2,520. The increase in value due to the access was therefore £31,233; allocating one-third of that sum to the purchase of the access (£10,411), the open market value of the subject land was £23,342.

It is clear that this decision, based as it is on the special interest of the person owning both the "brown strip" and the "green and purple land", provides no support for the general proposition that the owner of a ransom strip should be entitled to one-third of the increase in value of adjacent land for enabling that increase to be achieved. Insofar as the decision is of any general application, it suggests that the starting point should be that, in the absence of any other increase in value provided by the development of the adjacent land, the ransom strip is worth one-half of the increase in value of the adjacent land (an apparently rational approach), provided that the increase in value for these purposes is calculated after account has been taken of the expenditure and risk required to achieve the ultimate increase in value (by deducting a developer's profit and the cost of provision of necessary infrastructure). However, the valuation of a ransom strip and adjacent development land cannot reliably be done in reliance on this historic decision on special facts - rather, it is suggested, in a Lands Tribunal case, it must be a matter for expert evidence based on (i) the particular circumstances of the case, (ii) any comparable transactions available, (iii) finally an assessment by the expert of how the hypothetical bargaining process would be conducted in the circumstances of the case, having regard to any comparable evidence[4].

The so-called Stokes principle is of some topical interest, because it has been considered in a recent decision of the Chancery Division of the High Court, concerned with an issue similar to the valuation of a ransom strip, though not identical. The ability to "ransom" an owner of land with development potential is not restricted to an owner of other adjacent land. It is also available to a person who has the benefit of a restrictive covenant preventing development (although that may be subject to the jurisdiction of the Lands Tribunal to release or modify the covenant under section 84(1) of the Law of Property Act 1925) or easements preventing development, for example rights of way or rights of light.

In cases such as this, the Court may decline to grant an injunction preventing development, but instead may order the payment of "damages in lieu of an injunction". How should those damages be calculated? It is now well established that such damages should be assessed by ascertaining what sum might reasonably have been agreed by the parties for the grant of the right to proceed with the development, on the basis that they would each make reasonable use of their respective bargaining positions without holding out for unreasonable amounts. Some matters to be taken into account in considering such a hypothetical negotiation were set out by Mr. Anthony Mann QC (now Mann J.) in Amec Developments Ltd v. Jury's Hotel Management (UK) Ltd [2001] 1 EGLR 81 at 87, concluding with this final observation:

"As important as any of the above factors is this. In any negotiation, science and rationality gets one only so far. At the end of the day, the deal has to feel right".

An assessment of damages of this sort clearly requires evidence as to the amount of development value that would be released by the hypothetical agreement. This must be a matter for expert evidence. However, as the exercise required in a case such as this is not a property valuation, the amount of damages to be paid (being the result of the hypothetical negotiation) is not, apparently, a matter for the experts, but for the Judge. This was the view of Mr. Gabriel Moss QC in Tamares (Vincent Square) Ltd v. Fairpoint Properties (Vincent Square) Ltd [2007] 14 EG 106 (a case of infringement of rights of light). Mr. Moss QC said, at paras. 10 and 11 of his judgment:

"The estimates of profits on the relevant parts of the development were £163,000 on the claimant's expert right to light evidence and £186,000 on that of the defendant.

However, matters such as what percentage of the profit the hypothetical negotiation would actually arrive at and what is a reasonable share of the profit is a matter for me and not for the expert".

Mr. Moss QC reviewed the recent authorities relevant to this sort of claim for damages, at paragraph 22:

"(1) the overall principle is that the court must attempt to find what would be a "fair" result of a hypothetical negotiation between the parties;
(2) the context, including the nature and seriousness of the breach, must be kept in mind;
(3) the right to prevent a development (or part) gives the owner of the right a significant bargaining position;
(4) the owner of the right with such a bargaining position will normally be expected to receive some part of the likely profit from the development (or relevant part);
(5) if there is no evidence of the likely size of the profit, the court can do its best by awarding a suitable multiple of the damages for loss of amenity;
(6) if there is evidence of the likely size of the profit, the court should normally take into account a fair percentage of the profit;
(7) the size of the award should not, in any event, be so large that the development (or relevant part) would not have taken place had such a sum been payable;
(8) after arriving at a figure that takes into consideration all the above and any other relevant factors, the court needs to consider whether 'the deal feels right'.

Most of these propositions would be relevant to the valuation of a ransom strip as such - a property valuation. However, it is suggested that proposition (2) would not be relevant, as the size of the ransom strip would not in principle effect the value of the ransom.

It is therefore necessary to distinguish in some respects the valuation of a ransom strip and the similar exercise to be done in assessing damages to be awarded in lieu of an injunction. However, it is interesting to find in the judgment of Mr. Moss QC a reference to - indeed perhaps some reliance upon - the conventional understanding of the Stokes case. At paragraph 33 of his judgment, Mr. Moss QC found some assistance by reference to a one-third share of profit made in material put before the court at the original trial, when an injunction was refused. He then said (at paragraph 34):

"The use of a third share perhaps illustrates expectations in a negotiation of this kind, and seems to accord with common sense, which requires the proposed share of profit not to be so high as to put the developer off the relevant part of the development. It must be remembered that if a developer agrees to pay one-third of an expected development profit regardless of whether or not it is actually made, it will be taking a risk and the other party will not be. This helps to explain the reasonableness of the one-third; two-thirds split rather than say a 50:50 or 40:60 split in a commercial context. The one-third approach can also be derived by analogy from the approach of the Lands Tribunal in the compulsory purchase decision in Stokes v. Cambridge Corporation".

This reasoning in favour of a one-third split in development profit, to take account of the developer's risk, is entirely comprehensible and is supported by the conventional understanding of the Stokes decision. For what it is worth, it is not supported by an analysis of the actual reasoning in the Stokes decision as described above, where, amongst other things, developer's risk/profit was taken into account before the one-third split was calculated.

Nonetheless, it must be recognised that the judgment of Mr. Moss QC will be understood as giving support to the use of the "one-third rule" as a conventional approach, which is indeed perfectly reasonable provided that a figure for the developer's risk is not deducted twice. The judgment of Mr. Moss QC does not describe in detail how the valuers reached their profit figure of £163,000 and £186,000 and his conclusions were expressed as follows, in paragraphs 37 and 38:

*"I consider that the parties as hypothetical reasonable commercial people would take the halfway point between the two figures given by the expert valuer for loss **[meaning profit?]** based upon the rival right to light expert reports, namely £174,500. They would then agree prima facie a one-third split of that profit at £58,166 (ignoring the pence). However, taking into account the context of the relatively modest nature of the infringement in the present case and the need not to have a sum that would put the defendant off the relevant part of the development in that context, they would reduce that calculation to £50,000 as a "fair" result.*

I then ask myself the question: 'Does the deal feel right? It is very substantially more than any sum available for the loss of amenity, but in terms of the price of avoiding an injunction for infringing the claimant's right, it does feel 'right'. I would add that a figure above £50,000 in this case would not feel right to me, even if justifiable by the criteria set out above".

There is no scope for sensible criticism of the use of the "one third" approach, in principle, whether in assessment of a property valuation or of damages in lieu of injunction, provided it is used as part of an overall assessment of the development profit which might be made in any particular case and all the other circumstances of the case. It is not, however, supported by any general rule to be derived from the Stokes case which, if anything, might suggest a different approach, in the absence of the special circumstances of that case.

John Furber QC

jfurber@wilberforce.co.uk

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[1] The primary rules are now to be found in section 5 of the Land Compensation Act 1961.
[2] This is in accordance with the general rule that the parties to the hypothetical transaction are hypothetical persons. However, the general rule must not be used to defy common sense; thus, where the owner of the land being valued was also the owner of the ransom strip, this fact was not required to be disregarded: Fitzwilliam v. BRB [1967] 19 P & CR 588.
[3] The district valuer had allocated 50% of the increase in value to the ransom strip.
[4] Nonetheless, the "one-third rule" has been used in practice without, apparently, much analysis: see, for example, the decision of the Lands Tribunal in Haron Development Co. v. W. Sussex CC (1970) 230 EG 515.