To the victor the spoils?

Successful parties out of pocket: Fern Schofield & Anthony Tanney report on a hollow victory in the Court of Appeal

© Mike Ford / Alamy Stock Photo

IN BRIEF

- In *Mayor and Burgesses of the London Borough of Tower Hamlets v Khan*, the Court of Appeal considered the recoverability of the costs of First-tier Tribunal proceedings under a costs clause in a lease.
- The decision provides useful guidance for practitioners on the interpretation and drafting of similar clauses.

Ever since the original example (the victory of King Pyrrhus of Epirus over the Roman army at Asculum in 279BC), history has thrown up countless instances of so-called Pyrrhic victories. From our own (somewhat recondite) world of property litigation, we may now add another: *Mayor and Burgesses of the Tower Hamlets London Borough Council v Khan* [2022] EWCA Civ 831, [2022] All ER (D) 74 (Jun).

Background to the claim

Mr Ali Jivaraj Khan is the long-leasehold owner of a maisonette in a block of flats in east London, called Cambria House. The freehold owner of Cambria House, and Mr Khan's landlord, is the London Borough of Tower Hamlets. In 2016, Mr Khan was in arrears of service charge under his lease to the tune of £4,917 (presumably plus contractual interest under the lease). The borough therefore sent him a letter before action, threatening county court proceedings for the debt, to be followed thereafter by a notice preliminary to forfeiture of Mr Khan's lease under s 146 of the Law of Property Act 1925 (LPA 1925). When its letter failed to produce the desired response from Mr Khan, the borough issued its county court debt claim.

Success... at a price

Spoiler alert: the borough's debt claim succeeded. Not only that, Mr Khan was also adjudged both to have failed to put forward anything resembling a coherent defence to the claim, and to have behaved unreasonably in his conduct in relation to the proceedings.

Yet despite everything, the borough emerged from the proceedings substantially out of pocket: a true pyrrhic victory.

How so? When this sort of thing happens, the usual answer is legal costs, ie the successful party is for some reason unable to recover all or any of its costs from the losing party, and the shortfall exceeds the amount of the substantive claim.

As we shall explain in a moment, that was indeed what happened in this case.

But what, then, of the fact that Mr Khan's defence was found to have 'no merits'? And what also of his unreasonable conduct? Surely in those circumstances, the borough should have been granted a generous costs order against Mr Khan? If legal costs are the explanation for the borough's hollow victory, something else must have been going on. But what was it?

Forfeiture of long residential leases

Some explanatory background is needed. Readers will be familiar with notices preliminary to forfeiture, served under s 146, LPA 1925. The original purpose of these notices was to prevent a lessor forfeiting a lease for breach of a 'non-rent' covenant without first notifying the lessee, giving the latter a chance to mend his ways. It is therefore a little surprising to recall that by the 1990s, such notices—especially in service charge cases—had come to be regarded as a pernicious means for landlords to threaten defaulting lessees with termination of their valuable lease if they did not pay up. Parliament's baroque solution to this problem (and it is not hard to imagine much simpler alternatives) was s 81 of the Housing Act 1996 (HA 1996), as amended by the Commonhold and Leasehold Reform Act 2002 (CLRA 2002). As amended, s 81 provides that a landlord of a dwelling may neither forfeit a lease for non-payment of service charge, nor even serve a s 146 notice as a preliminary thereto, unless a tribunal, court or arbitrator has first determined that the sum in question is lawfully due. Leases where service charges are reserved as rent do not escape this regime. For although s 146 does not in general apply at all to forfeiture for non-payment of rent, it was soon held that s 81, HA 1996 (as amended) had changed the law where the 'rent' claimed was, in substance, a service charge.

By starting its debt proceedings against Mr Khan, the borough was therefore simply obeying s 81, HA 1996 (as amended). So far, so good. However, no sooner had the borough adopted its chosen course, than the county court exercised its undoubted power to transfer to the First-tier Tribunal (FTT) the question of whether the charges claimed by the borough were 'reasonable'.

The claim for costs

It was here, from the borough's viewpoint, that matters began to unravel. On the issue of 'reasonableness', the FTT found in the borough's favour. But that left the question of costs. The FTT's power to make an order for costs in favour of one party is limited to cases where the other party has behaved 'unreasonably'. In the view of the FTT, Mr Khan's behaviour had been unreasonable, but there were mitigating factors, making it inappropriate to make a costs order against him. Therefore, the FTT refused the borough's application to that effect.

The matter then returned to the county court to enter judgment on the debt claim. When it did, the borough renewed its attempt to recover its costs, this time relying on a covenant in Mr Khan's lease (a course not open to the borough in the FTT). By that covenant—clause 3(9) of Mr Khan's lease—Mr Khan agreed to pay legal costs incurred by the borough 'in or in contemplation of any proceedings in respect of this lease under s 146 of the Law of Property Act 1925 including in particular costs incidental to the preparation and service of a notice under the said section'.

The borough, by its counsel, disavowed any claim that the FTT costs were incurred 'in contemplation of' proceedings under s

146, but submitted that those costs were 'incidental to' preparation and service of a s 146 notice, within the meaning of clause 3(9). This was because such proceedings were, by law, a necessary preliminary to service of such a notice. The district judge agreed, and made an order requiring Mr Khan to pay the borough's costs of both the county court proceedings, and those of the proceedings in the FTT, in a single assessed sum.

In so far as the district judge's order related to the costs in the FTT (presumably the bulk of the costs), Mr Khan appealed to the Court of Appeal which, on 21 June 2022, allowed his appeal.

The judgment of the Court of Appeal

Newey LJ (with whom Macur and Nugee LJJ agreed) gave the only judgment. He noted that the borough, having obtained judgment for the debt, had not then actually gone on to serve a s 146 notice, but had instead taken a charging order over Mr Khan's lease. In those circumstances, Newey LJ concluded that it was wrong to describe the borough's costs in the FTT as 'incidental to' the preparation and service of a s 146 notice. Those costs were 'too remote' from such a notice, and also too large to be said to be 'incidental' to the almost-certainly-much-smaller costs of preparing and serving the notice itself.

Newey LJ also dealt with two further points taken by the borough in a respondent's notice. The first was that the borough's FTT costs were incurred 'in contemplation of' proceedings under s 146. This was a new point, not advanced in the court below. Newey LJ accepted that costs could be incurred 'in contemplation of' a notice that was never actually served. But to know what the borough was 'contemplating' required an investigation into what was in the mind of the borough at the material time. This was a matter of evidence, not explored in the court below. Newey LJ therefore refused permission for the borough to advance this argument on the appeal.

> *"The result of the Court of Appeal's decision appears somewhat extraordinary"*

The second point in the respondent's notice was that the county court had power to make an order in respect of the FTT costs, by reason of the court's general power to award costs in s 51 of the Senior Courts Act 1981. This point had been advanced below, albeit the district judge had not needed to address it. Newey LJ, resolving apparently conflicting previous authority, held that that the effect of the statute enabling the county court to transfer proceedings to the FTT (s 176A, CLRA 2002) was also to remove the court's s 51 jurisdiction in respect of costs incurred in that forum. However, even if that was wrong, the court would not have exercised its s 51 jurisdiction in the borough's favour when the FTT itself had already refused the borough's application for costs of those proceedings. In the result, the order for costs made in favour of the borough by the district judge was therefore to be limited to the costs of the county court element of the claim.

Contemplating the future

The result of the Court of Appeal's decision appears somewhat extraordinary. In particular, the decision rendered worthless the borough's undoubted legal right to the payment by Mr Khan of the debt. In retrospect, the borough would have done better simply writing the debt off (though try telling that to the ratepayers). Moreover, the reason the FTT has such a limited costs-shifting power is so that lessees with genuine reasons for non-payment of service charges can have those reasons considered by a tribunal without fear of bankruptcy if their defence to payment ultimately fails and they have to pay the landlord's costs on top. That was hardly the case with Mr Khan. Finally, provisions like clause 3(9) of Mr Khan's lease are themselves the subject of intensive statutory regulation as 'administration charges' (s 158, CLRA 2002, above). There is accordingly no need for the court to interpret such clauses restrictively—as the cases (including those relied on by Newey LJ) arguably do.

But on closer examination, *Tower Hamlets v Khan* is in fact no charter for service charge non-payers. First, the outcome may well have been different had counsel relied before the district judge on the words 'in contemplation of' in clause 3(9) of Mr Khan's lease. Second, it will be a rare case in which the FTT finds a party to have behaved unreasonably (as it did with Mr Khan) yet declines to exercise the costs-shifting jurisdiction that it does possess. Third, landlords who succeed in the FTT and wish to escape the consequences of Newey LJ's reasoning potentially could do so by incurring the relatively modest additional cost of then actually serving a s 146 notice (indeed, it would be an irony if this decision led to a proliferation of s 146 notices). Fourth, and finally, in the case of leases yet to be granted, provisions such as clause 3(9) could be drafted more tightly, to include specific reference to costs in the FTT.

None of the above suggestions undo the result in *Tower Hamlets v Khan*, however. They are of no use to the ratepayers of the borough, who are unlikely to be consoled by knowing that they follow in a long line of hollow victories going back to the classical age. As they might say: *O tempora! O mores!* **NLJ**

Fern Schofield & **Anthony Tanney** are barristers at Falcon Chambers (*www.falcon-chambers.com*).

Property is one of the most complex areas of law. Some of it is rooted in ancient laws – but case law is constantly changing. The stakes are high, but research ti me is in short supply. LexisPSL Property brings all of the diff erent sources you need together so you can fi nd the answers you need, fast.

Trial today
www.lexisnexis.co.uk/legal/property-law

LexisNexis®