Case No: B3/2002/9001 CCRTF
B3/2001/6019 FC3

Neutral Citation Number: [2002] EWCA Civ 1830

IN THE SUPREME COURT OF JUDICATURE
COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM CENTRAL LONDON
COUNTY COURT (His Honour Judge Goldstein)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 16 December 2002

Before :

LORD JUSTICE KAY
and
LADY JUSTICE ARDEN

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Between :

Piera Smith	**Appellant**
- and -	
Ashfaq Ahmed Spaul	**Respondent**

- -
- -

Miss Josephine Henderson (instructed pro bono) for the Appellant
Mr Richard Alomo (instructed by **Messrs Dhalokia Cummings-John**) for the Respondent

Hearing dates : 15 November 2002

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JUDGMENT : APPROVED BY THE COURT FOR HANDING DOWN (SUBJECT TO EDITORIAL CORRECTIONS)

Lady Justice Arden :

1. This appeal is brought by the landlord of the premises known as Flat C, 103 Gloucester Place, London, against the assignee of the 99 year lease dated 7 October 1983 of those premises ("the premises"). The appeal is brought with limited permission granted by Ward LJ against the order for costs contained in the order of His Honour Judge Goldstein, sitting in the Central London County Court. The main part of the order struck out the appellant's claim for forfeiture based on a notice pursuant to section 146 of the Law of Property Act 1925 dated 18 May 1995 ("the section 146 notice") on two grounds. The order for costs was that the appellant should pay £15,000 on account of costs by 4.00 p.m. on 12 November 1999. The only ground on which this appeal is now advanced is that one of the grounds on which the judge struck out the proceedings was based on the erroneous conclusion as a matter of law that a mortgagee in possession of the premises could effectively serve a counter-notice pursuant to the Leasehold Property (Repairs) Act 1938 ("the 1938 Act"). That meant that the appellant could not commence proceedings to enforce the section 146 notice in respect of breaches to which the 1938 Act applies without the leave of the court.

2. Accordingly the short point of law which this appeal raises is whether the mortgagee in possession of premises is the "lessee" for the purposes of section 146 of the Law of Property Act 1925 and section 7 of the 1938 Act. It is surprising that this precise point has not previously been considered by the higher courts since there must in practice be many cases where a lessor wishes to obtain possession of premises he has let but the lessee had mortgaged his interest to a mortgagee who has taken possession.

3. The statutory definition of "lessee" is the same for both sections and it is expressed in wide and general, but non-exhaustive, terms:-

> "'Lessee' includes an original or derivative under-lessee, and the persons deriving the title under a lessee; also a grantee under any such grant as aforementioned and the persons deriving title under him," (s146(5)(b))

4. The relevant statutory scheme is as follows. Under the Law of Property Act 1925, a landlord cannot enforce a right of forfeiture in a lease unless he serves on the lessee a notice requiring (if the breach is capable of remedy) the lessee to remedy the breach and (in any case) to pay compensation and containing other particulars required by section 146(1). The lessee is then given a reasonable time to remedy the breach (if capable of remedy) and to pay compensation. If a section 146 notice is served, the lessee can claim relief from forfeiture. Moreover, any under-lessee can apply to the court for an order vesting the lease in him (section 146(4)).

5. The 1938 Act provides that where a section 146 notice is served to enforce a repairing covenant, or claims damages for breach of a repairing covenant, and the lease has three years or more unexpired, the section 146 notice must contain a notice that the lessee is entitled to serve a counter-notice claiming the benefit of the 1938 Act. That benefit is principally contained in 1(3) of the 1938 Act:-

> "(3) Where a counter-notice is served by a lessee under this section, then, notwithstanding anything in any enactment or rule of law, no proceedings, by action or otherwise, shall be taken by the lessor for the enforcement of any right of re-entry or forfeiture under any proviso or stipulation in the lease for breach of the covenant or agreement in question, or for damages for breach thereof, otherwise than with the leave of the court."

6. Furthermore, the circumstances in which the court can grant leave under section 1(3) are limited. For instance, leave may not be given unless the lessor proves that he will suffer a substantial loss in the value of his reversion if the breach is not immediately remedied (section 1(5)).

7. The mischief which the 1938 Act was designed to remedy was:-

> "speculators buying up small property in an indifferent state of repair, and then serving a schedule of dilapidations upon the tenants which the tenants cannot comply with. I am not saying that was this case, but it is the general mischief, that the speculator buys at a very low price, turns out the tenants and gets the reversion which he has never paid for, which is a great hardship to the tenants" (per Lord Goddard CJ in *National Real Estate and Finance Company Ltd v Hassan* [1939] 2 KB 61, CA).

8. The factual background necessary to determine this appeal can be stated briefly and I can do so using the summary in the respondent's skeleton argument. The appellant is, and was at all material times, the freeholder of the block of flats known as 103, Gloucester Place, London W1. In October 1983, the appellant granted a Mr French a lease of Flat C for 99 years, commencing September 1983. In November 1985, Mr French assigned his lease to a Dr Moore. In 1998 Dr Moore converted the flat into a two-bedroomed flat with a bathroom and kitchen at mezzanine level. In 1998 Dr Moore sold the flat to Mr Omiros Mavrovouniotis. Dr Moore was required to pay and did pay, the sum of £11,162.48 to the appellant as compensation for his alterations to Flat C before a licence to assign was granted. Mr Mavrovouniotis bought Flat C with the aid of an advance from Halifax Building Society ("Halifax"), in whose favour he executed a charge.

9. In March 1995, Halifax obtained a possession order in respect of Flat C at the Central London County Court. At about the same time the appellant purported to repossess Flat C. However, in May 1995 the appellant allowed Halifax back into possession. On 19 May 1995 the appellant served a notice under section 146 on Halifax. On 22 May 1995 the solicitors acting for Halifax served a counter-notice on the appellant's solicitors claiming, among other things, the benefit of the 1938 Act. In June 1995 Mr Spaul, the respondent to this appeal, bought Flat C from Halifax at an auction. On 15 November 1995, the appellant commenced proceedings for possession of Flat C on the basis of the section 146 notice, served on 19 May 1995. Pleadings were served and the matter came on for trial in 1999. The judge decided to deal with two

preliminary issues: first, whether the appellant was in breach of the provisions of the 1938 Act in not obtaining leave of the court to bring the action, and, second, whether the appellant was estopped from bringing the action to enforce a breach not covered by the 1938 Act by reason of her conduct over the years. The judge found against the appellant on both issues. As regards the 1938 Act, the judge held that (apart from paragraph A of the schedule of breaches attached to the section 146 notice, with which we are not concerned), the notice related to breaches of covenant to keep the property in repair and that those items fell within the 1938 Act. There is no appeal from that part of his ruling or on the second issue. The debate has centred on the judge's conclusions of law on the first issue: was Halifax a lessee for the purposes of section 1(3) of the 1938 Act?

10. It is common ground that a mortgagee qualifies as a lessee within the statutory definition set out above, as indeed, might a number of other persons in any given case.

11. In *Egerton v Jones* [1939] 2 KB 702 a mortgagee of a leasehold interest claimed that he should have been given notice pursuant to section 146. The Court of Appeal held that it was unnecessary to give the mortgagee notice. Sir Wilfred Greene MR, with whom Mackinnon and Finlay LJJ agreed, held:-

> "Accordingly in the case of a mortgagee by subdemise that mortgagee is always at the risk of a lessor obtaining re-entry for breach of covenant without the mortgagee knowing anything about it; in which case the mortgagee is completely shut out. Every mortgagee, therefore, knows that this is the risk he runs. If, after taking a covenant from his mortgagor to observe the covenants in the lease, he takes no steps whatsoever to satisfy himself from time to time that no breach of covenant is taking place, he is always exposed to the risk that, behind his back and without his knowledge, the lessor will succeed in re-entering, and so determining the lease, with the result that all possibility of relief from forfeiture is lost to the mortgagee. That is one of the risks of the game."

12. In *Church Commissioners for England v Ve-Ri-Best Manufacturing Co* [1957] 1 QB 238, the lessee in possession sought to rely on a counter-notice served by the mortgagee. Lord Goddard CJ held that in the context of a section 146 notice the expression "lessee" meant the lessee in possession. Accordingly, the lessee in possession could not rely on the counter-notice served by the mortgagee. In the course of argument, Counsel for the plaintiffs (Mr R E Megarry QC) conceded that it might have been necessary to give notice to the mortgagee if he had been in possession. That cautious and Delphic concession assumed importance in a later case which I consider below.

13. In *Kanda v Church Commissioners for England* [1958] 1 QB 332, the sequence of events was that a section 146 notice was served on a tenant, the tenant served a counter-notice, the landlord obtained leave under the 1938 Act to proceed against the tenant but the tenant then assigned his lease. The Court of Appeal held that there was

no need to serve a fresh section 146 notice on the assignee, but that a further application for leave under the 1938 Act had to be made.

14. In *Cusack-Smith v Gold* [1958] 1 QB 611, an under-lessee who had assigned his lease was held not entitled to the benefit of the 1938 Act even though a counter-notice had been served by him or his predecessor. Pilcher J said in the course of his judgment that it was not in dispute that

> "where the word 'lessee' appears in this section it can only refer to the lessee in possession or one who has a subsisting lease at the time when proceedings for forfeiture or re-entry are taken."

Later the judge held that the protection afforded by the 1938 Act was intended to be confined to lessees in possession or lessees having a present estate or interest in the premises.

15. In *Old Grovebury v Seymour Plant Sales* [1979] 3 All ER 504, the Court of Appeal held that, where an assignment had occurred, the section 146 notice should be served on the assignee, and not the original lessee, even though the assignment was in breach of covenant. There was privity of estate between the lessor and assignee. In *Horsey Estate Ltd v Steiger* [1899] 2 QB 79, at 91, Lord Russell of Killowen CJ held that the purpose of a section 146 notice is "to give the person whose interest it is sought to forfeit the opportunity of considering his position before an action is brought against him."

16. In *Target Home Loans Ltd v Iza Ltd* [2000] 1 EGLR 23, His Honour Judge Cowell, distinguished the situation in the *Ve-Ri-Best* (above), where the mortgagee had not taken possession, from the situation where a mortgagee had taken possession. In his judgment a mortgagee in possession was the only person who could remedy the breach and therefore the notice under section 146 had to be served on him and he could give the counter-notice under the 1938 Act:

> "The purpose underlying the requirement in section 146(1) of service of notice on the lessee is the practical one that the lessor wants something done and that the lessee served may choose to do what is required of him to be done by the notice and so avoid forfeiture. The lessee in possession is ordinarily the person best able to do what is required. Being the person required in practice to comply with the notice, he is the person entitled to choose the protection of the 1938 Act, particularly if he considers that the landlord is guilty of the kind of abuse that the 1938 Act was designed to prevent and that the landlord is not likely to obtain the lease of the court under section 1(5). Put another way, the person entitled to be served is 'the person who is interested in getting the notice so that he can make up his mind what if anything he can do about avoiding forfeiture', as Lord Russell of Killowen said in *Old Grovebury Manor Farm Ltd v W Seymour Plant Sales & Hire Ltd (No.2)* [1979] 3 All ER 504 at pp 505-506, where it was held that a notice

> served on a former leaseholder who had assigned the term was invalid because the assignee, the present leaseholder, was interested in receiving the notice in the absence of which forfeiture could not be had.
>
> If the mortgagor has lost possession of the leasehold property because the mortgagee has taken possession, so that any retaking of possession would be a trespass (it might even be a contempt of court if possession had been given to the mortgagee by a warrant having been executed), service of a section 146 notice on the mortgagor would be pointless because he cannot lawfully do anything to remedy the breach. The landlord cannot forfeit without serving a notice. In such a case it must follow that the only person who could remedy, and hence the only person the landlord can require to remedy, the breach is the mortgagee in possession. True it is, in such a case, the mortgagor retains an estate in the term, but he has no possession of the property. Even the estate is under the control of the mortgagee, and, in the absence of redemption, can be assigned away by the mortgagee in exercise of the mortgagee's statutory power to sell it. In such a case, the mortgagee has both an estate or interest in the term, or the equivalent if he is a legal chargee, and possession of the property. He also has control over the mortgagor's estate."

17. The judge in the *Target* case also placed reliance on the concession made by counsel in the *Ve-Ri-Best* case (see above).

18. Miss Josephine Henderson, for the appellant, submits that the *Target* case was wrongly decided. In any event, it is not, of course, binding on this court. She submits that the word "lessee" in section 146(1) depends on the contractual context. The phrase "lessee in possession" as used, for example, in the *Ve-Ri-Best* case refers to the current tenant with whom there is a privity of estate. The fact that the mortgagee is in possession is irrelevant because there is no contract or privity of estate between the mortgagee in possession and the lessor (see for example *Bonner v Tottenham and Edmonton Permanent Investment Building Society* [1899] 1 QB 161, 166). Entry into possession is essentially an interim remedy to protect security and does not give rise to a contractual relationship. An order for possession does not create any interest in property.

19. Moreover, it would, on her submission, be a violation of the lessor's rights under article 1 of the First Protocol to the European Convention on Human Rights ("the Convention") to give effect to a counter-notice served by a person who is not in a contractual relationship with the lessor since it diminishes his right to claim possession and/or damages. In the case of a tenancy entered into prior to the coming into force of the Landlord and Tenant (Covenants) Act 1995, only the tenant is liable for damages for disrepair and accordingly it was wrong in principle to allow a person who has no liability in damages under the covenants to interfere with the enforcement of obligations under the lease.

20. Miss Henderson further submits that this court accepted in *Egerton* that the mortgagee could be completely shut out. The landlord may not even be aware that the mortgagee has taken possession. The mortgagee and other sub-tenants are affected by forfeiture and are entitled to apply for relief, but not to prevent the proceedings from being brought in the first place. There is no public interest in allowing a person who happens to be in possession to interfere with contractual rights between the parties. Rights of occupation are respected by allowing such a person the right to apply for relief from forfeiture.

21. Mr Richard Alomo, for the respondent, submits first that Halifax was the lessee in possession, and therefore, the person entitled to serve a counter-notice and second, that in any event, on the authority of *Kanda v Church Commissioners for England*, there had to be an application for leave to proceed against the assignee in any event.

Conclusions

22. I start with section 1 of the 1938 Act. Section 1(4) provides:-

> "(4) A notice served under subsection (1) of section one hundred and forty-six of the Law of Property Act 1925, in the circumstances specified in subsection (1) of this section, and a notice served under subsection (2) of this section shall not be valid unless it contains a statement, in characters not less conspicuous than those used in any other part of the notice, to the effect that the lessee is entitled under this Act to serve on the lessor a counter-notice claiming the benefit of this Act, and a statement in the like characters specifying the time within which, and the manner in which, under this Act a counter-notice may be served and specifying the name and address for service of the lessor."

23. This makes it clear that the person entitled to notice under section 1 is the same person as is entitled to notice under section 146.

24. Section 146(1) requires the notice required by that sub-section to be served on "the lessee":-

> "(1) A right of re-entry or forfeiture under any proviso or stipulation in a lease for breach of any covenant or condition in the lease shall not be enforceable, by action or otherwise, and until the lessor serves on the lessee a notice –
>
> a) specifying the particular breach complained of; and
>
> b) if the breach is capable or remedy, requiring the lessee to remedy the breach; and

c) in any case, requiring the lessee to make compensation in money for the breach;

and the lessee fails, within a reasonable time thereafter, to remedy the breach, if it is capable of remedy, and to make reasonable compensation in money, to the satisfaction of the lessor, for the breach."

25. Although the expression "the lessee" is defined in very wide terms by section 146(5)(b) (set out above), the particular lessee required to be served under section 146(1) must be the person who vis-à-vis the lessor is bound to remedy a breach or to make compensation in money.

26. As between the lessee and a mortgagee of his leasehold interest, the person bound to the lessor will be the lessee. This is because whether a leasehold interest is mortgaged by way of a sub-demise for a term of years absolute or by way of a charge by way of legal mortgage, the term of the mortgagee will be for a period less than the leasehold interest and will thus take effect by way of sub-demise or sub-lease (see the Law of Property Act, section 86(2) and section 87(1)). This means that the relationship of lessor and lessee is unaffected by the mortgage. This remains the position if the mortgagee takes possession (see the *Bonner* case, above). In any event, the conventional view is that the mortgagee of a leasehold interest takes the risk that the landlord will forfeit the lease and he must be observant to ensure that the tenant mortgagor observes the covenants in the lease. As Sir Wilfred Greene MR put it in *Egerton v Jones*, the risk of forfeiture is "one of the risks of the game."

27. Furthermore, section 146 already confers protection on the mortgagee of a lease by conferring on him the right to apply to the court for an order vesting the leasehold interest in himself (see section 146(4)). The question is whether the mortgagee should be entitled to the additional protection provided by section 1 of the 1938 Act, which prevents the lessor from proceeding against the tenant without the leave of the court. However, while it is established that the mischief against which section 1 of the 1938 Act is directed is the protection of tenants against speculators (see above), there is nothing in the authorities to suggest that the mortgagee deserves this additional protection too. There is nothing, therefore, to suggest that the protection which the mortgagee is given by section 146(4) is not adequate.

28. The reasoning in *Target* is effectively that possession should be the touchstone for entitlement to a notice under section 1 of the 1938 Act because the person in possession – whether the tenant or a mortgagee – is the person who was able to remedy the breach set out in the section 146 notice. However, the fact that the mortgagee is in possession is not an absolute bar to the tenant remedying the breach. He can first redeem the mortgage or remedy the breach with the mortgagee's consent. Accordingly, it does not necessarily follow that the fact that the mortgagee is in possession means that the mortgagee is the only person able to remedy the breach. Moreover, the mortgagee is not the person who is liable to the lessor to remedy the breach or to make compensation. Accordingly, even if the mortgagee is in possession, I see no reason why he should receive a notice under section 146(1) or a notice under section 1 of the 1938 Act. In my judgment, the *Ve-Ri-Best* decision applies equally

where the mortgagee is in possession and the concession made by counsel in that case was correctly framed in terms of possibility only.

29. Thus, in this case, Halifax was not entitled to serve a counter-notice under section 1 of the 1938 Act. Moreover, the lessor was not obliged to serve the section 146 notice on the respondent, who had not then taken an assignment of the lease. The proceedings were not instituted in breach of section 1 of the 1938 Act and the judge was wrong to decide the question of costs in part on that basis.

30. In these circumstances, in my judgment, the appeal should be allowed. The exercise by the judge of his discretion as to costs must be set aside. This court has not heard submissions on the amount of costs attributable to the estoppel issue. This relates to repairs which are not within the 1938 Act and the appellant does not contend that the judge's conclusion on the estoppel issue was in error. In those circumstances, unless the parties can agree on the appropriate proportion of costs attributable to the ground on which the judge struck out the proceedings not under appeal, the matter will have to be remitted to the Central London County Court for the appropriate order to be made. It would obviously be sensible for the parties to agree that apportionment. If agreement is not possible, the court would encourage the parties to participate in its alternative dispute resolution scheme. Details may be obtained from Case Management Section B in the Civil Appeals Office.

Lord Justice Kay

31. I agree.