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INTRODUCTION

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Welcome to this bulletin from 1 Chancery Lane's Property, Chancery and Commercial Law team.

In this edition:
John Bryant analyses a recent decision on waiver of the right to forfeit which applies known principles to a demand of insurance rent;
Chris Pask looks at the standard the court requires when controlling the conduct of an administrator;
Maurice Rifat writes about the issues at stake in his forthcoming Supreme Court case of *Stoffel v Grondona*; and Henk Soede (one of our pupils) explains how the Court of Appeal has resolved the question of whether the 'reasonable recipient' test applies to statutory possession notices.

WAIVER OF RIGHT TO FORFEIT: SUBLETTING AND INSURANCE RENT

JOHN BRYANT

A case reported last month is an instructive reminder of the circumstances in which a landlord might waive his right to forfeit a lease.

In *Faiz v. Burnley B.C.* [2020] EWHC 407 (Ch) the first two claimants (Faiz), were the lessees of a café. The local authority, the freehold owner, was their landlord under a ten-year lease granted in 2010. The lease contained restrictions on assignment and sub-letting and a proviso for re-entry. The provisions of sections 24 to 28 of the 1954 Act were excluded.

In the proceedings Faiz asserted that they had entered into a sublease dated 1st August 2017 with a company called SASSF Ltd, the third claimant, which ran the café business. In fact, as the judge found, SASSF entered into occupation in late September or early October 2017 as Faiz's licensee. It was probably in May 2019 that the sublease was entered into and backdated.

In 2018 the council became aware that SASSF was in occupation of the premises but were not aware that it was in occupation other than as a licensee. They decided that on its expiry in 2020 they would not renew Faiz's lease. Having demanded and accepted rent throughout the lease, on 26th September 2019 they sent Faiz a demand for insurance rent in the sum of £2,845.20 for the period ending on 25th February 2020.

By a letter dated 18th October 2019 solicitors instructed by the claimants wrote to the council, saying:
(1) you are aware that since 1st August 2017 SASSF has occupied the café;
(2) SASSF has occupied it pursuant to a sublease dated 1st August 2017 (enclosing a copy);
(3) as a sub-tenant, SASSF is entitled to "a subsisting right to occupy the property upon the expiry of the lease" (referring to *D'Silva v. Lister House* [1971] Ch 17 and *Brimex Ltd v. Begum* [2009] L&TR 21).

That was the first the council knew of the sublease and on 30th October 2019 they served notice on Faiz under section 146 LPA, seeking to forfeit the lease for a breach of the prohibition on subletting, which they stated was incapable of remedy.

The insurance rent remained outstanding and on 4th November 2019 the council sent Faiz a revised invoice, apportioning the rent so as to encompass only the period ending on 18th October 2019, the date of the claimants' solicitors' letter, and thus demanding only the sum of £1,826.87. On 11th November 2019 Faiz paid that sum.

On 22nd November 2019 the council purported to exercise their right of forfeiture by peaceable re-entry. The claimants started proceedings, seeking a declaratory relief as to their rights. Faiz submitted:
(1) that by January 2018 at the latest the council knew that SASSF was in occupation and, relying on *Metropolitan Properties Co Ltd v. Cordery* (1980) 39 P&CR 10, should be deemed to have had knowledge of the 2017 sublease from about that time. Having demanded and accepted rent thereafter, the council had plainly waived their right to re-enter; alternatively,
(2) having become aware of the existence of the sublease on 18th October 2019, their demand for the insurance rent on 4th November and their acceptance of payment a week later were each waivers of the council's right of re-entry by the time they purported to forfeit on 22nd November.

Judge Halliwell decided that there had been no waiver by the council. He referred to *Kammins Ballrooms Co Ltd v. Zenith Investments (Torquay) Ltd* [1971] AC 850 and Parker J's "classical statement of the law" in *Matthews v. Smallwood* [1910] 1 Ch 777 at 786-787. In summary, a waiver can occur only where the lessor with knowledge of the facts upon which his right to re-enter arises does some unequivocal act recognising the continued existence of the lease. In *Cornillie v. Saha and Bradford & Bingley Building Society* (1996) 72 P&CR 147 at 155-156 Aldous L.J. added that the landlord's act of recognition must be communicated to the tenant.

On analysis the council by acceptance of rent had not waived their right to forfeit prior to receiving the

solicitors' letter of 18th October 2019 because up to then they had not known of the existence of any sublease. Having been put on notice in January 2018 of SASSF's occupation, they should have made inquiries to ascertain the precise nature of the breach, if any (see *Cordery*). Had they done so, however, they would have discovered the existence not of a sub-tenancy but a licence.

As for the demand for insurance rent, the judge referred to para.17.098 of Woodfall and to *Price v. Worwood* (1859) 4 H & N 512 and *Osibanjo v. Seahive Investments Ltd* [2008] EWCA Civ 1282, preferring Mummery L.J.'s analysis in the latter case.

The critical question was whether or not the liability of Faiz to pay the sum of £1,826.87 for insurance rent accrued after the council first obtained knowledge of the sublease. The claimants said yes, arguing that the 4th November demand should be regarded as a fresh demand for which Faiz under the terms of the lease became liable to make payment within seven days. The judge disagreed. It would have been clear to a reasonable recipient of the revised invoice that the council had elected to limit their demand for insurance rent to the period before they had knowledge of the breach and had re-calculated the invoice on that footing. They had thereby shown an intention to reserve their rights of forfeiture.

In any event it was not clear that the council had to reserve its rights in that way. Faiz's obligation to pay the insurance rent arose in September before the council had notice of the sub-lease. That obligation included a liability to pay in respect of a period falling after they had notice. In general a landlord does not waive a right to forfeit by demanding and accepting rent in respect of a liability incurred before it has notice of the relevant breach regardless of whether the liability is in respect of future rent.

The crucial points arising from the decision are these:
1. The right to forfeit accrues only once the landlord has knowledge of the breach.
2. Once a landlord knows of third party occupation he should make inquiries to ascertain the exact position. Otherwise he may be deemed to have knowledge of the breach.
3. If acting for a landlord with such knowledge, identify what debts arose before he acquired that knowledge.
4. Make a demand, if at all, only for those debts.
5. Any demand for debts arising after the date of knowledge will probably amount to a waiver.

COURT'S CONTROL OF ADMINISTRATORS: "UNFAIR" OR "UNCONSCIONABLE"?

CHRISTOPHER PASK

The long running Lehman Brothers saga, a product of the last financial crisis, continues with Lehman Brothers Australia Ltd (In Liquidation) v Macnamara & Ors (Joint Administrators of Lehman Brothers International Europe) (In Administration)) [2020] EWCA Civ 321.

Facts

The liquidators of Lehman Brothers Australia ("LBA") brought an application against the administrators of Lehman Brothers International (Europe) ("LBIE") to correct a mistake in a proof of debt which it had submitted to LBIE to settle intercompany claims.

The mistaken figure arose from a clerical error and was recorded in a settlement deed between the parties in 2014. It was subsequently noticed by a prospective purchaser in 2016. The mistake arose because a figure in the underlying settlement calculations was denoted in Australian Dollars rather than Euros. This resulted in the claim submitted by LBA and settled by LBIE being approximately £1.7m less than it should have been.

LBA sought agreement from LBIE to correct the mistake and whilst LBIE did not dispute the error, it refused on the basis that they had entered into over two thousand similar agreements with the aim of providing certainty and finality to LBIE creditors and feared opening the floodgates to other challenges.

Issues

LBA sought a direction from the court that LBIE accept the proof of debt at the higher figure which they did not dispute it should have been in the first place.

They relied upon the principle established in *Ex parte James* (1873-74) LR 9 Ch App 609 that the court has an inherent power to order an insolvency office holder not to rely on his strict legal rights where doing so would cause injustice or would be regarded as 'unjust by all right-minded men'.

The liquidators alternatively relied on the court's statutory power pursuant to paragraph 74 of Schedule B1 of the Insolvency Act 1986 ("paragraph 74"), which allows a creditor to bring a challenge where an administrator is proposing to act in a way which would unfairly harm the interests of the applicant.

First Instance Decision

In the High Court, Hildyard J refused LBA's application. The judge held that there was no basis for the court to intervene in these circumstances with the contractual rights which the parties had entered into freely, albeit with an erroneous figure included.

When considering the applicable test under the principle in *Ex parte James*, the judge found that 'unconscionability' was required, rather than merely 'unfairness' for the court to intervene.

Similarly, the judge held that LBIE enforcing the settlement deed's contractual terms did not amount to 'unfairly harming' the interests of LBA within the meaning of paragraph 74.

LBA appealed.

Court of Appeal

Unanimously, the Court of Appeal decided that the judge had erred and allowed the appeal. It proceeded to deal with (i) the appropriate test for intervention by the court under the principle in *Ex parte James* and (ii) the proper approach to a claim under paragraph 74.

In reviewing the authorities on the *Ex parte James* principle Richard Davies LJ rejected the position that unconscionability rather than mere unfairness was required [paragraphs 35 – 69 of the judgment]. At paragraph 68 he concluded:

"While the formulation of the test in the authorities, involving so many phrases with perhaps different shades meaning, has something of the quality of dancing on pinheads, resolution of this issue lies in going back to the fundamental principle underlying the jurisdiction. The court will not permit its officers to act in a way that it would be clearly wrong for the court itself to act. That is to be judged by the standard of the right-thinking person, representing the current view of society. If one were to pose the question "would it be proper for the court to act unfairly?", only one answer is possible…"

As regards statutory power in paragraph 74, the test was again one of unfairness but the power under paragraph 74 was a wide one and the requirement for some form of discrimination, which had been imported by the court below, was not supported by the wording of paragraph 74. Davies LJ held [at paragraphs 83 and 84]:

"83. Discriminatory conduct could certainly amount to unfairness, even assuming that it was not an unlawful exercise of the power, but again I see no reason in the terms or purpose of paragraph 74 for confining it to cases of discrimination. If that were right, conduct that met an objective test of unfairness would engage paragraph 74 only if the administrator had treated differently another creditor in the same position. That is a conclusion that cannot, in my judgment, be justified by the terms or purpose of paragraph 74.

"84. Paragraph 74 is expressed in wide terms, and it adopts the objective standard of fairness. It is right that, in judging whether any conduct can be said to have caused unfair harm, it is a factor of great importance that the administrator is carrying out statutory functions and is or should be doing so in the interests of creditors as a whole, but that may still involve the infliction of unfair harm on a particular creditor. That is true of any case to which the principle in Ex parte James might apply. So, in Ex parte James itself, it would have been in the best interests of creditors as a whole, and conducive to achieving the purpose of the bankruptcy, for the trustee not to repay the money paid under a mistake of law. The court will adopt a cautious approach but there are no grounds for subjecting the provisions of the paragraph to mandatory qualifications that are not to be found in it."

The result was that the court held that no right-thinking person would think it fair for the administrators to

stand on their strict contractual rights and refuse to correct a shared mistake for which they were as responsible as LBA [paragraph 103].

Commentary

The judgement provides helpful guidance on how courts should approach the application of the *Ex parte James* principle and challenges brought under paragraph 74. It noted that a number of assumptions and differing use of language had arisen in the previous authorities, leading to a lack of clarity as to how the control of the court's officers should be exercised.

It makes it clear that cases involving the principle in *Ex parte James* will critically turn on their particular facts but that there is nothing unfair in the principle; the court can intervene when in the eyes of a right thinking person, something has gone unfairly wrong.

The judgment also confirms that there is no general principle that *Ex parte James* and paragraph 74 cannot be applied to 'contractual rights freely entered into' as the court below had attempted to assert. Whilst it was accepted that that was a highly material factor against the grant of relief, the Court of Appeal made clear that it should not be elevated into an absolute bar to relief.

WHEN IS ILLEGALITY A DEFENCE IN A PROFESSIONAL NEGLIGENCE CLAIM?

MAURICE RIFAT

The Supreme Court is again set to deal with the issue of illegality in May 2020 in *Stoffel & Co v Grondona*. The Respondent, Ms Grondona, represented by Maurice Rifat of 1 Chancery Lane, was successful both at trial and in the Court of Appeal in relation to her claim for damages for loss of a leasehold interest in property following her solicitor's negligent failure to register both her interest and her bank's charges.

The solicitors defended on the basis that she had made deceitful representations to her bank to obtain a mortgage to purchase the property. She had failed to disclose her prior agreement with the vendor, Mr Mitchell, that he would remain as the beneficial owner and manage the property while she would enjoy 50% of the property value upon eventual sale. The issue is whether this fraudulent conduct undermines her claim for negligence.

At first instance the case was decided in Ms Grondona's favour. The judge held that the correct test to apply in order to determine whether the claim was defeated by the *ex turpi causa* was not whether the illegality was closely connected, or inextricably linked, with the claim against the defendant, but whether she relied upon that illegality to found her claim: *Tinsley v Milligan* [1994] A.C. 240 at [76].

Shortly after Ms Grondona's success the Supreme Court delivered judgment in *Patel v Mirza* [2017] A.C. 467 and ruled that *Tinsley v Milligan* was no longer to be followed as it did not satisfy the policy consideration for the illegality principle that the law should be coherent and should preserve the integrity of the legal system.

The Supreme Court ruled that instead the court should assess whether the public interest would be harmed by enforcement of an illegal agreement, which requires it to consider (a) the underlying purpose of the prohibition which has been transgressed (b) any other relevant public policy on which the denial of the claim may have an impact and (c) whether denial of the claim would be a proportionate response to the illegality.

When the solicitor's appeal in *Stoffel & Co v Grondona* was heard the Court of Appeal applied the new framework prescribed by the Supreme Court in *Patel v Mirza*. The Court of Appeal, nevertheless, dismissed the appeal recover as damages a sum equivalent to the value of the property. Applying the *Patel v Mirza* guidelines that the Court of Appeal held that: (a) that the denial of the claim would enhance the underlying purpose of the rule against mortgage, namely protection of the mortgagee, was questionable. There was no public interest in allowing solicitors to avoid their liabilities because they discover after the event that their client had made misrepresentations to their mortgage provider. It is preferable that a solicitor be wary of fraud from the outset and appreciate that they should be alive to, potential irregularities in a transaction [para 37]; (b) there was a genuine public

interest in ensuring that clients who use the services of solicitors are entitled to seek civil remedies for negligence/breach of contract against a defendant arising from a legitimate and lawful retainer which was entered into between them, in circumstances where the client was not seeking to profit or gain from her mortgage fraud, but merely to ensure that that the chargee's security was adequately protected by registration [para 38]; (c) it would be entirely disproportionate to deny the claim if one takes into account factors such as the fact that the 'victim' chargee itself raised no complaint on the grounds of fraud but adopted the transaction [para 39(i)] and that Ms Grondona's illegal conduct was not central, or indeed relevant, to the otherwise proper and legitimate contract of retainer between the claimant and the defendant or indeed to the claimant's claim in the present action; it was simply part of the background story [para 39(iv)].

The Supreme Court granted permission to the solicitor on the question of whether the Court of Appeal erred in the application of the *Patel v Mirza* guidelines.

One of the issues at play in the Supreme Court will concern the problematic nature of the application of the illegality defence to negligence claims. The Court of Appeal recognised that the leasehold property had been validly transferred to Ms Grondona despite the transfer being for an illegal purpose and thus required the protection of registration, which her solicitor failed to do. It is one thing to deny a claimant the profits of her illegal conduct, but quite another to deprive her of compensation for injury or loss to property suffered which she is otherwise entitled to recover.

The Supreme Court will also have to grapple with the question of whether the retainer was 'central' to the fraud. The Appellant's argue that the retention of a firm of Solicitors was central to the fraud as the 'purpose' of the Solicitor's retainer was to commit fraud the Supreme Court will have to consider whether such an analysis mistakes 'purpose' for 'motive'. The 'purpose' of the contract was for the Solicitor to carry out the formalities of registration and this he failed to do. The 'motive' of the Respondent was to facilitate a background fraud, but there would be considerable uncertainty if professionals are able to avoid liability whenever their client has an improper or illegal motive for their retainer, such as a wish to pay less tax or to avoid paying alimony.

The Respondent will be represented in the Supreme Court by Andrew Warnock QC & Maurice Rifat, both of 1 Chancery Lane, and by Laura Giachardi of 42 Bedford Row.

MISTAKES IN STATUTORY POSSESSION NOTICES

HENK SOEDE

In *Pease v Carter* [2020] EWCA Civ 175, the Court of Appeal addressed an ambiguity in the case law relating to whether the 'reasonable recipient test' set out in *Mannai Investment v Eagle Life Assurance* [1997] AC 749 applied to notices served under section 8 of the Housing Act 1988 ('the HA 1988'). The Court held that it does and in doing so reiterated the principles that apply to the interpretation of statutory notices.

Background

On 7 November 2018 the Appellant ('the Landlord') served notices of proceedings for possession ('the Notices') under section 8 of the HA 1988 on the Respondents ('the Tenants') following repeated non-payment of rent. Unfortunately, the Notices incorrectly stated (as a result of a typographical error) that court proceedings would not begin until after "26 November 2017" when they should have said "26 November 2018"

Proceedings below

On 27 December 2018 the Landlord issued proceedings in the County Court. At the first hearing, DJ Adams identified the typographical error but permitted the Landlord to amend the error and rely on the notice. The Tenants appealed. On appeal, the Landlord relied on the reasonable recipient test' as laid down by the House of Lords in *Mannai*. HHJ Garman, relying on *Fernandez v McDonald* [2003] EWCA Civ 1219, held that although the 'reasonable recipient' would have realised the error and understood what the

Notices should have said, that test did not apply to notices served under section 8 of the HA 1988. The Notices were accordingly held to be invalid.

The Landlord appealed on two grounds: 1) the Judge was wrong to hold that the 'reasonable recipient' test did not apply to section 8 notices; 2) alternatively, the Judge was wrong to hold that the Notices were not "substantially to the same effect" as the prescribed form. Both grounds were ultimately successful.

Ground 1

Having reviewed *Fernandez and Spencer v Taylor* [2013] EWCA Civ 1600 (which concerned a section 21 notice) the Court of Appeal held that the Judge was wrong to hold that the 'reasonable recipient test' did not apply to section 8 notices. The Judge had erred in his analysis of Hale LJ's judgment in *Fernandez* when deciding that the 'reasonable recipient test' was inapplicable where the statutory requirements of a notice are clear, precise, easy to comply with, and involved only minor consequences in the event of non-compliance. On Arnold LJ's reading, *Fernandez* was not authority for the proposition that the approach in *Mannai* is inapplicable to statutory possession notices. Such notices are to be interpreted from the perspective of "a reasonable recipient reading it in context".

The Court rejected submissions that this interpretive latitude would cause issues for practical justice. Arnold LJ considered that even the busiest district judges would have no issue applying the *Mannai* approach and that a bright-line test was therefore unnecessary. It remains to be seen whether the Court's optimism was justified.

Ground 2

Arnold LJ also held that the Judge had erred in holding that the Notices were not "substantially to the same effect" as the prescribed form, but noted that the Judge did not benefit from having either *Ravenseft Properties v Hall* [2001] EWCA Civ 2034 or *Obsorn v Dior* [2003] EWCA Civ 281 cited to him. Those decisions clearly established that, contrary to the Judge's view, the "substantially to the same effect" test applies not only to the wording used but also to information inserted into the form.

Three key questions

Following the Court of Appeal's decision in *Pease*, the correct approach to statutory notices, summarised by Arnold LJ at para 39, can be said to consist of three questions:

(1) How would the notice be interpreted by the 'reasonable recipient reading it in context'?

(2) Does the properly interpreted notice comply with the relevant statutory requirements?

(3) If the properly interpreted notice does not comply with the relevant statutory requirements but there is a "substantially to the same effect" provision, can the notice nonetheless be said to be "substantially to the same effect" insofar as it still achieves the purpose of the statutory requirements?

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