UPPER TRIBUNAL (LANDS CHAMBER)

Neutral Citation Number: [2016] UKUT 311 (LC)
Case No: LRX/92/2015

TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

LANDLORD AND TENANT - ADMINISTRATION CHARGE – whether charge for final demand letter payable under covenant to indemnify landlord against all costs in respect of breach of covenant – appeal dismissed

IN THE MATTER OF AN APPEAL AGAINST A DECISION OF THE FIRST-TIER TRIBUNAL (PROPERTY CHAMBER)

BETWEEN:

FAIRHOLD FREEHOLDS NO.2 LIMITED **Appellant**

- and -

ALISTAIR C MOODY **Respondent**

Re: 64 Shepherd's Walk,
Bradley Stoke,
Bristol
BS32 9AY

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Determination on written representations

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The following cases are referred to in this decision:

Assethold Limited v Watts [2014] UKUT 0537 (LC)
Christoforou v Standard Apartments Limited [2013] UKUT 0586 (LC)

Introduction

1. Where a tenant fails to pay a £50 instalment of ground rent is the landlord entitled to charge a further £50 for a letter demanding payment of the arrears where the only relevant covenant on the part of the tenant is an obligation "to indemnify the Lessor against all actions proceedings costs claims and demands in respect of any breach non-observance or non-performance" of the tenant's obligations under the lease?

2. That question of interpretation is the main issue arising in this appeal from a decision of the First-tier Tribunal Property Chamber ("FTT") made on 5 August 2015.

3. The sums involved in this appeal are trivial, but the covenant in question, or variants of it, are standard in many leases and the issue is of some importance to larger landlords wishing to defray the cost of administering their property portfolios.

The Facts

4. The respondent, Mr Moody, is the lessee of a two bedroom flat in Bristol under a lease granted to him on 21 December 2006 by a predecessor of the appellant, Fairhold Freehold No.2 Limited, which acquired the freeholder reversion to the lease in 2008.

5. The lease is for a term of 250 years and reserves a ground rent of £100 per year payable by equal half-yearly instalments in February and August. By clause 4.1 of the lease the lessee covenanted to observe and perform the obligations contained in the eighth schedule which include an obligation to pay the ground rent.

6. The appeal turns on the meaning of clause 4.1, by which the lessee covenanted with the lessor:

> "to observe and perform the obligations on the part of the Lessee set out in Parts I and II of the Eighth Schedule and to observe and perform all covenants and stipulations contained or referred to in the Charges Register (if any) of the Title above referred to so far as the same relate to or effect the Demised Premises and to indemnify the Lessor against all actions proceedings costs claims and demands in respect of any breach non-observance or non-performance thereof."

7. Mr Moody does not live at his flat in Bristol and he had previously provided the appellant's agent with a correspondence address, which at the time was his home address. In August 2013 he moved house to a new address in Southampton. He informed the management company (responsible under the lease for maintaining the building and collecting the service charge) of his change of address; but he did not inform the appellant or its managing agent, Estates and Management Limited, which is responsible for the collection of the ground rent. Nor did the management company inform the appellant or its agent of Mr Moody's new address.

8. In July 2014 the appellant's agent sent out a demand for the next instalment of ground rent, but addressed the demand to Mr Moody at his original address. The demand did not reach him and he did not pay the ground rent instalment which fell due on 1 August 2014 (his liability to pay was not conditional on receiving a demand). Two chasing letters also went unanswered. Eventually the agents carried out a search against the title to the flat at the Land Registry. By that means they discovered Mr Moody's current address, to which they sent a further letter on 14 November 2014 headed "Final Letter Before Action" demanding payment of the £50 ground rent together with the sum of £50 for their administration charges in pursuing the respondent for the arrears.

9. When received the demand Mr Moody paid the £50 ground rent by return but disputed the administration charge. He asked the appellant's agent to explain how his obligation to pay that charge was said to arise. In response the agents referred to a number of provisions in the lease, including clause 4.1.

10. Mr Moody's £50 cheque for the ground rent was returned by the appellant's agents on the ground that the balance due on his account was £100. Why that was thought to be a reason for refusing to accept the tendered payment of the undisputed sum has never been explained by the appellant.

11. When the next instalment of rent fell due on 1 February 2015 Mr Moody tendered it in the same way, but once again his cheque was returned on the grounds that he had not paid the full amount due, including the disputed administration charge. On 13 March 2015 the appellant's agents added a further administration charge of £150 for instructing solicitors to recover the outstanding charges. Those solicitors themselves made a charge of £180 which was added to Mr Moody's rent account on 19 March 2015.

12. By that stage Mr Moody had had enough and on 31 March 2015 he applied to the FTT for a determination under paragraph 5(1) of Part I of Schedule 11 to the Commonhold and Leasehold Reform Act 2002 of his liability to pay the administration charges and as to the reasonableness of those charges. By the time his application was determined by the F-tT the appellant had finally deigned to accept the outstanding ground rent of £100 and the sole dispute concerned the administration charges.

The FTT's decision

13. In its decision the F-tT considered a number of issues which are no longer live between the parties and then referred to the decision of the Tribunal in *Assethold Limited v Watts* [2014] UKUT 0537 (LC) which concerned the question whether the terms of a lease were sufficiently clear to enable a landlord to add the costs of legal services to the service charge. The Tribunal had said this:

> "I accept that, as a general principle of interpretation, if contracting parties intend that a payment obligation such as a service charge should cover a particular type of expenditure they will wish to make that clear. Unclear language should therefore be read as having a narrower rather than a wider effect. Nonetheless, I do not think that principles should be pushed to the

> point where language which was clearly intended to encompass expenditure in a wide variety of situations which the parties have not explicitly catalogued should be so restrictively construed as to deprive it of any real effect. It seems to me wrong in principle to start from the proposition that, with certain types of expenditure, including the costs of legal services, unless specific words are employed no amount of general language will be sufficient to demonstrate an intention to include that expenditure within the scope of a service charge. The language may be clear, even though not specific."

14. The FTT also referred to the Tribunal's decision in *Christoforou v Standard Apartments Limited* [2013] UKUT 0586 (LC) which concerned the recovery of costs incurred by the landlord in pursuing the tenant for unpaid service charges. In that case the Tribunal held that the landlord was entitled to recover those costs under a covenant by the tenant "to be responsible for and to keep the Landlord fully indemnified against all damages, losses, costs, expenses, actions, demands, proceedings, claims and liabilities made against or suffered or incurred by the Landlord arising directly or indirectly out of … any breach or non-observance by the tenant of the covenants conditions or other provisions of this lease…."

15. The F-tT concluded that the appellant was not entitled to levy an administration charge for the late payment of ground rent in reliance on clause 4.1, and explained its reasons in the following two paragraphs of its decision:

> "26. The Tribunal had at the forefront of its mind when construing clause 4.1 of the lease in the instant case, that specific wording relating to administration charges for late payment was not necessarily required in order for a charge to be levyable. However, the Tribunal considered that the general wording of that clause was not sufficient to encompass such charges. In construing the words "indemnify the Lessor against all actions proceedings costs claims and demands" the Tribunal considered that they had to be construed *ejusdem generis* and that this clause was designed to protect the lessor from claims made against it, that it was defensive in nature and was not intended to apply to situations where the Lessor took the initiative and instigated action against the Lessee.
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> 27. The Tribunal also had regard to the lease as a whole and considered that if the landlord had intended to be able to levy administration charges for late payment of ground rent that this would have been included within the Eighth Schedule as specific reference to the legal costs was made in paragraph 4 thereof."

16. The FTT's reference to paragraph 4 of the Eighth Schedule was to the lessee's covenant to pay all costs charges and expenses (including legal costs) incurred by the lessor in or in contemplation of any proceedings under section 146 of the Law of Property Act 1925. The Lease included other provisions relevant to the remedies available to the landlord and the manager in the event of non-payment of sums payable to them by the lessee. By paragraph 3 of part I of the eighth schedule the lessee covenanted to pay interest at the rate of 4% above base rate on any arrears of rent outstanding for more than 14 days. By clause 4.2 the lessee covenanted with the manager to observe and perform the obligations on the part of the lessee in the eighth schedule. In contrast to clause 4.1 this covenant did not require the lessee additionally to indemnify the manager against actions, proceedings, costs, claims and demands in respect of any breach, non-observance or non-

performance of the obligations in the eighth schedule. The manager is entitled, however, to include the cost of enforcing or attempting to enforce the observance of the covenants on the part of any lessee of any of those flats as an item in the service charge payable by all lessees of flats in the building (paragraph 8 of Part C of the sixth schedule).

17. Finally, the FTT ordered the appellant to reimburse the fee of £65 which Mr Moody had incurred in making his application.

The issues on the appeal

18. The appellant was granted permission to appeal on two grounds. The first issue is whether the FTT was right to find that clause 4.1 did not entitle the appellant to recover the administration charges including the £50 charge for sending the final demand letter. The second ground of appeal concerns the order for the appellant to reimburse the application fee of £65; the appellant suggested that if it was right in relation to the first ground of appeal the F-tT's order for reimbursement ought to be set aside.

Discussion and conclusion

19. Clause 4.1 is a covenant of indemnity intended to protect the lessor against the adverse consequences of a breach by the lessee of its obligations to the lessor. The essence of a contract or covenant of indemnity is that it is a promise by A to protect B from B's liability to C. For a liability to arise under a covenant of indemnity the party to be indemnified must have come under an obligation to a third party, to meet a claim or demand or to answer some action or proceedings or incur some costs. The question in any case where it is sought to rely on such a covenant is whether the lessor has come under an obligation to make a payment to someone else "in respect of" some breach of obligation owed to the lessor by the lessee: has A's breach given rise to B's liability to C? If the lessor has come under such an obligation the covenant requires the lessee to indemnify the lessor against the cost it has incurred in meeting that obligation.

20. The covenant refers to two different sets of obligations. The first comprises the obligations on the part of the lessee set out in Parts I and II of the Eighth Schedule, while the second comprises covenants and stipulations contained or referred to in the Charges Register (if any) so far as they relate to or effect the demised premises. As a matter of construction of the clause the duty to indemnify applies to both sets of obligations, and to all actions, proceedings, costs, claims and demands in respect of any breach, non-observance or non-performance of them.

21. The F-tT described clause 4.1 as "defensive in nature" and has not been intended to apply to situations where the lessor "took the initiative and instigated action against the lessee". That seems to me aptly to describe one essential characteristic of a covenant of indemnity, namely that A's breach must give rise to B's liability to pay C, or in the context of a leasehold covenant, that the lessee's breach must have given rise to an obligation on the part of the lessor to make a payment to some third party. The "actions, proceedings, costs, claims and demands" against which the lessor is

entitled to be indemnified are clearly actions, proceedings, claims and demands made against the lessor, and the addition of "costs" to the list does not convert the lessee's liability into one for any costs which the lessor may incur as a result of taking steps of its own against the lessee. The "costs" in question are of the same type i.e. the costs of a third party as a result of the lessee's breach, for which the third party is entitled to look to the lessor for reimbursement. A covenant of indemnity is not the same as a covenant to reimburse the lessor's own costs incurred in taking steps to enforce the lessee's obligations.

22. I derive some modest support for this construction from the lessee's covenant given to the manager in clause 4.2 which contains no obligation to indemnify against costs claims and demands in respect of any breach of any of the covenants in the eighth schedule, but which is supplemented by the right to recoup through the service charge the costs of enforcing the observance of the covenants on the part of any lessee. The equivalent protection given to the lessor against costs of enforcement is a more limited one and appears in paragraph 4 of Part 1 of the eighth schedule in the form of the lessee's covenant "to pay all costs charges and expenses, including legal costs, incurred by the Lessor in or in contemplation of any proceedings or service of any notice under section 146". It would be inconsistent with that restrictive entitlement to recover costs incurred by the lessor as a result of a breach of covenant by the lessee if clause 4.1 were to be construed as imposing a liability on the lessee to meet all of the costs which the lessor might incur in enforcing the lessee's covenants.

23. The appellant placed reliance on the Tribunal's decision in *Christoforou* in support of its claim to recoup the costs of pursuing the respondent for payment of the ground rent, but I do not think the decision in that case is of assistance. The covenant in *Christoforou* was not simply a covenant of indemnity but included an obligation by the tenant to be responsible for all costs incurred by the landlord arising directly or indirectly out of any breach. That language is very much wider than clause 4.1.

24. I am therefore satisfied that the F-tT came to the right conclusion and that clause 4.1 does not enable the appellant to levy a £50 administration charge or to recoup the costs of its own solicitors in preparing to enforce the respondent's obligation to pay the ground rent. To the extent that the appellant was under any obligation to make payments to its agent or solicitor as a result of those steps being taken such obligations were not the result of the respondent's failure to pay the ground rent, but of the appellant's own instructions. The agent's costs of instructing the solicitor and the solicitor's costs of opening the file are irrecoverable for the additional reason that, as the lessee was not liable for the £50 administration charge and had tendered the unpaid rent in full before solicitors were consulted, he cannot be liable for the lessor's costs of seeking to enforce payment when none was due.

25. Three further short points arise. The first is that the respondent sought a determination from the F-tT under paragraph 2 of Schedule 11 to the 2002 Act that the amount of the charges levied by the appellant was not reasonable. He pointed out that the letter sent to him was computer generated and did not justify a charge of £50. The appellant defended the quantum of the charge by suggesting, as its agent had done in earlier correspondence, that the charge was "necessary to us to recoup our costs incurred following late payment …. and [is] used to cover our administrational and legal costs, postage and labour costs, as well as lease storing and retrieval and IT infrastructure costs."

26. Had I considered that the appellant was entitled in principle to an indemnity in respect of costs incurred as a result of the non-payment of a single instalment of ground rent I would have required persuasion that the indemnity could extend to a contribution to the general running expenses of the appellant or its agent. Most of those expenses would be incurred in any event, whether or not the lessee was in breach of covenant, whereas the indemnity could, at best, cover the costs incurred as a result of the lessee's breach.

27. Secondly, the respondent included in his application to the FTT an application under section 20C, Landlord and Tenant Act 1985 for an order that costs incurred by the appellant in connection with these proceedings ought not to be treated as relevant costs to be taken into account in determining the amount of any service charge payable by the respondent and the other tenants on the estate. The FTT do not seem to me to have given appropriate consideration to that application. They treated it as a separate answer to the claim for administration charges and decided that it was not necessary to deal with it. I am satisfied that it is not necessary to make an order under section 20C in this case because the service charge provisions do not permit the recovery of costs and expenses incurred by the lessor, as opposed to those incurred by the manager (which is a party to the lease in its own right and not as agent for the lessor). There is therefore no basis on which the respondent can be liable for costs incurred by the appellant in connection with this appeal or in connection with the proceedings before the FTT.

28. Finally, the FTT also ordered the appellant to reimburse the respondent the fee of £65 which he had incurred in bringing his application. That order came at the end of a paragraph in which the FTT was critical of the behaviour of the appellant's agents and in which it suggested that they might have taken a more reasonable approach. The FTT did not identify the specific power under which it made the order for reimbursement but it seems clear that it was intended to be made under rule 13(2) of the Tribunal Procedure (First-tier Tribunal) (Property Chamber) Rules 2013 which empowers the FTT to make an order requiring a party to reimburse any other party the whole or part of the amount of any fee paid by the other party. The FTT gave no indication, despite its criticisms of the appellant's agent, that it intended its order to be made under rule 13(1)(b) which allows it to make an order for costs if a person has acted unreasonably in bringing, defending or conducting proceedings in a residential property case. The appellant certainly seems to have understood the FTT to have intended its order to be made under rule 13(2) as is apparent from its application for permission to appeal dated 11 September 2015. It was surprising therefore to find the appellant's statement of case dated 10 December 2015 address the second ground of appeal on the assumption that the order for reimbursement had been made under rule 13(1)(b).

29. The appellant's second ground of appeal is that it should not have been ordered to reimburse the £65 application fee, because it should have succeeded in the application. That ground of appeal must fail as I have determined that the FTT reached the correct conclusion on the main issue. No question of reasonableness or unreasonableness arises for consideration.

Martin Rodger QC

Deputy President

31 August 2016