CA On appeal from High Court Liverpool County Court : His Honour Judge Mackay before Schieman LJ, Buxton LJ, Dyson LJ. 9th June 2003.

LORD JUSTICE SCHIEMANN

1. Lord Justice Dyson will deliver the first judgment.

JUDGMENT : LORD JUSTICE DYSON:

2. This is an appeal by the defendant from a decision of His Honour Judge Mackay given on 3 September 2002 in relation to costs. There is also an application by the claimant for permission to cross-appeal another decision as to costs given by the same judge on the same day. The court gives permission to the claimant to make that cross-appeal.

3. The defendant is a house builder. He agreed to build a house for the claimant. The defendant served a notice to complete the contract of sale. The claimant contended that the defendant was not entitled to serve the notice on the grounds that the house had not been constructed in accordance with its contractual obligations. In particular he claimed that there were defects which prevented the house from being fit for occupation. The claimant issued proceedings in which he sought an injunction to prevent the defendant from relying on the notice to complete. These proceedings were settled on terms that the defendant would not act on the notice to complete until trial or further order and that all further proceedings be stayed for the purpose of carrying into effect the alternative dispute resolution agreement that had been entered into by the parties. So far as material this agreement provided:

> *"3. The Architect nominated as a result of the process in Paragraph 2 above shall be instructed jointly by the parties to consider the existing report: on the property the subject of this dispute, and the contract between the parties for its construction, to inspect the property in whatever way he may see fit, and to prepare a report setting out what, if any defects or unfinished work exist at the property. He shall in his report identify any defects as falling into one or other of two categories, that is to say:*
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> *(a) those that are such as to make the property not ready for immediate occupation*
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> *(b) those of a minor nature which would not reasonably inconvenience the immediate occupation of the property by any purchaser.*
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> *4. Within 14 days of receipt of the report, the Defendant shall commence carrying out the works required by the Architect. The Defendant shall notify the architect as and when he contends that the works in category (a) above have been completed. The architect shall thereafter inspect the property and if satisfied that the works have been carried out in a good and workmanlike manner so as to make the property ready for occupation he shall issue a certificate to that effect. Upon receipt of any such certificate by the parties, the Defendant shall be entitled to issue and serve a Notice to Complete and the Claimant shall not be entitled to challenge the validity of the same.*
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> *5. On receipt of the architect's certificate the Claimant and the Defendant agree that the injunctions granted herein be discharged.*
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> *6. Within 42 days of completion the Defendant shall complete in a good and workmanlike manner any items shown in the architect's report under category (b) above. In the event of any disagreement as to whether these works have been satisfactorily completed, either party may apply to the architect to re inspect the same, and any certificate he gives shall be binding on the parties.*
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> *7. For the purposes of the letter of instruction to the architect, the claimant and the defendant agree that they will be jointly and severally liable for the fees of the architect in respect of the works he is instructed to carry out, and in so far as the Architect may require payment of any fees in advance, they will pay those fees in equal shares. As to the liability for the costs of the architect as between themselves, the parties agree that those costs shall be treated as part of the costs of this action, and paid as they may agree or as may be assessed by the court."*

4. Pursuant to the agreement, a Mr Miller was appointed as the expert to conduct the ADR. He produced a report on 20 June 2000. The report contained two lists of remedial works. Category A works were those that were to be carried out by the defendant before it was entitled to serve a notice to complete;

and Category B works were to be carried out after completion but before 11 September. In so far as he considered that one of the parties had caused abortive visits or asked him questions, Mr Miller subsequently looked to the party responsible for those acts for payment of his fees. Otherwise he simply split his fee (which included the cost of obtaining advice from a structural engineer) on a 50/50 basis between the parties in accordance with clause 7 of the ADR agreement. The defendant carried out the Category A works and the sale was completed on 1 August 2000, but the Category B works continue to give rise to dispute.

5. Meanwhile on 19 July the claimant had issued proceedings in the Liverpool County Court against the defendant alleging breach of contract. He served particulars of claim on 12 December 2000. He alleged that there were many defects in the house. The defence and counterclaim was served on 29 December 2000. It was subsequently amended on three occasions, the last of these being on 28 June 2002. By the date of trial on 2 September 2002 the outstanding issues between the parties had been reduced to the following:
    1. Was the claimant entitled to general damages for delay in completing the dwelling.
    2. Did the ADR agreement estop the defendant from denying that the house was not ready for occupation on the date set out in the notice to complete.
    3. The costs of rectifying the outstanding defects identified by Mr Miller were agreed at £10,290-odd, and the cost of remedying the further defects identified by subsequent experts were agreed in the sum of £1,748-odd. It was agreed that the claimant had spent £3,495-odd in performing some works and replacing some fittings. Disputes arose in that the defendant maintained that (a) it was not responsible for the costs of re-laying the lawn (£2,301-odd incurred by the claimant) and (b) since the claimant had obtained planning permission to extend the dwelling the sum of £1,208-odd would not be expended.
    4. The defendant maintained that it had been released from carrying out some of the items of work by agreement with the claimant, and that it was not required to perform the remaining works because the claimant had maliciously spread water in the inside of the dwelling and that this amounted to a repudiatory breach of the ADR agreement.
    5. There was an issue as to whether some works performed by the claimant's father for which the claimant was entitled to credit.
    6. The defendant had constructed a wall as an additional item and counterclaimed £4,002-odd for this work. The claimant denied liability to pay for the wall on the grounds that he said that there had been no agreement to pay for it.
6. On 9 October 2001 the defendant made a Part 36 payment of £7,500.
7. On 11 March 2002 the defendant made a without prejudice offer offering to accept £7,500 plus costs to date, on terms that the defendant would replace the window seals without cost to the claimant.
8. On 10 April 2002 the claimant made a Part 36 offer to accept £15,000 plus £9,926 being the cost of instructing surveyors in connection with the ADR agreement and the cost of the action.
9. On 13 May 2002 the defendant made a further Part 36 offer. It offered £10,750, and to pay the costs of the action to be the subject of a detailed assessment. The claimant rejected this offer on the following day.
10. On 20 August 2002 the claimant made an open offer to accept £12,750 plus costs to be assessed. The defendant's response was to offer to pay £8,750 plus costs.
11. As I have said September 2 was the first day of the trial before His Honour Judge Mackay. The estimated length of the trial was four days.
12. On the morning of 2 September before the case was opened, the judge said that in his view the matter was one which was wholly uneconomical to try. He estimated that the total costs of the action could be as much as £100,000 and noted that the sums in dispute were dwarfed by the costs at issue. He said that it was his view that the parties were now arguing about the costs of the action and that view was one with which both counsel agreed. The judge said that he would rise in order to give the parties an opportunity to settle the matter, indicating that this was the outcome that he expected.

13. The problem facing the parties was whether the claimant would succeed in obtaining a judgment for more than £10,750 after taking into account the counterclaim. That was of course the sum that had been offered by the defendant on 13 May 2002.

14. Three issues of costs separated the parties. First, the costs reserved in the Chancery Division by Judge Hegarty when the injunction proceedings were stayed; secondly, the claimant contended that he was entitled to the costs of the ADR process as part of the costs of the action; thirdly, the defendant, although accepting that each party should pay the costs of the action up to the date of its offer of 13 May 2002, contended that thereafter the correct order was no order for costs. As a result of negotiations at the behest of the court, the parties agreed to split the difference between the offers of £10,750 and £12,750, and to settle at £11,750 on the basis that this was an economic settlement and did not involve any concession by either party in relation to the current Part 36 offer. The parties were not however able to resolve the three issues of costs to which I have referred, and they agreed that if the judge would consent to do so he should be asked to resolve those questions of costs. That is what happened. The judge agreed to proceed on that basis.

15. Immediately after the judge had indicated that he was willing to take that course, the following exchange took place between Mr Bradley, who was counsel appearing for the defendant, and the judge:

"MR BRADLEY: Because, your Honour, it is anticipated that we will not be in any way asking your Honour to say who would have won, if won be the phrase.

THE JUDGE: I tell you frankly, I have not the faintest idea who would have won this case. That is not my problem. It is the fact that the case is being tried. You would have a much better idea as to who would win it because, as I said, the question 'what will the Judge decide' most people know the answer to that. 'What is my case' that is a different matter entirely and the two questions are not, as it were, the same in any way at all. Is it therefore the idea that we all go away and come back tomorrow or at 2.15 or what?"

The parties did go away and submissions were addressed to the judge on 3 September.

16. On the first issue the judge found that the claimant was entitled to the costs reserved by Judge Hegarty and no appeal arises from that part of his decision. On the second issue the judge declined to order that the defendant should pay the costs of the ADR procedure. He held that the costs of the ADR should lie where they fell, save where Mr Miller had ordered otherwise. In his judgment on this issue Judge Mackay said this:

"4. I am also conscious that the claimant had to go to court but at court, before Judge Hegarty QC, they anticipated ADR. That is to avoid court hearings. That is the alternative dispute resolution and the order for costs do not follow the event in ADR, it is meant to avoid costs, and that is why the agreement between the parties was open ended with regard to costs and gave the court the power to award costs if it thought fit.

5. I am also conscious that whilst the surveyor found many defects with regard the premises he did not find as many as the claimant was asserting and this action, inasmuch as it is to implement the findings of the surveyor in the ADR procedure, amounts to a lot less than what the claimant was saying when he brought the matter before Judge Hegarty.

6. The surveyor himself had an input into the costs situation and his order was that each party pay their own costs but where there were instances of further investigation ... of expert's reports and the like which were, in fact, or may have been, in fact, without merit the surveyor said that the person who brought that situation about should pay the costs and it may well be that the claimant is that person.

7. In all the circumstances, therefore, I do not consider that it is appropriate to award the ADR costs to the claimant. It may well be that part of those costs and the experts' reports and the like, which went into the ADR, inasmuch as they form part and parcel of the claimant's case, could be recovered by the claimant with regard to the costs awarded in these proceedings, but I am not going to make any order with regard to the costs in this matter before these proceedings opened."

17. Since the judge ruled on the ADR costs issue before deciding who should pay the costs of the action it is convenient to take the cross-appeal first. Mr Mulholland submits that the judge ought to have awarded the claimant all of the costs of the ADR save for those which Mr Miller had already disposed of. Mr Mulholland says that the claimant was the successful party in the ADR proceedings. The central issue to be resolved by Mr Miller was whether there were Category A defects sufficient to disentitle the defendant from serving a notice to complete. That issue was resolved in favour of the claimant. That is Mr Mulholland's primary submission. He also contends that the judge misdirected himself at paragraph 6 of his judgment; he submits that it was incorrect to say, as the judge did, that Mr Miller's order was that the parties should pay their own costs. I would reject Mr Mulholland's primary submission. Paragraph 5 of the judgment is critical. The judge took into account the fact that the defects found by Mr Miller were "a lot less than what the claimant was saying when he brought the matter before judge Hegarty." In deciding where the burden of costs should fall the judge was entitled to have regard to the extent to which the claimant's claim was exaggerated. Mr Bradley makes the point that the claimant was saying in the ADR proceedings that the house was suffering from substantial structural defects. It was these allegations which led Mr Miller to retain the services of a structural engineer, thereby increasing the costs. In the result Mr Miller rejected all these serious allegations and found five Category A defects of a different and altogether more modest character.

18. In my judgment there is, however, some force in Mr Mulholland's second submission. It does appear that the judge misunderstood the import of Mr Miller's order as to costs, and that this may have had some influence on the judge's overall decision. Mr Miller did not order that the parties should pay their own costs. It is therefore open to this court to exercise the discretion that was vested in the judge afresh. In my opinion the judge reached the correct conclusion. It is clear that both parties achieved some success notice in the ADR proceedings. The claimant demonstrated that there were some Category A defects which justified the position which he had taken in relation to the notice to complete. The defendant however showed that the claimant's case in relation to category A defects were substantially overstated; there was success for both parties. I would therefore dismiss the cross-appeal.

19. As regards the costs of the action, the judge said this:

> *"2. In this case there have been a number of offers and, indeed, it is right to say that those offers from the defendant are not enough and those from the claimant are more than the sum which has been regarded as the decisive sum. I recognise that Mr Bradley said when he said that this is not a finding of the court and, therefore, the £11,750 is picking a figure. Picking a figure after I had given the strongest indication that I thought the suspense ought to go and we ought to just have a resolution of this case because the costs were enormous and we were set down for four days and, as Mr Bradley said rightly, it might not have taken four days, it might have taken longer than four days. So the £11,750 is not, as it were, an intellectual figure that has been reached after much examination of all the evidence and it may well be, had the case gone on, I would have found the appropriate figure to be more or less than that.*
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> *3. We look at the offers and see what relationship they have to that figure and they are on each side of it and so the figure may not be perfect but it is an indication of two things: first of all, of the lack of value of the case and, secondly, of the fact that the parties can, when pushed, reach a figure.*
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> *5. Also, the claimant, in the open letter of the 20th August 2002 finally, thankfully, dropped the ADR costs and, in fact, put forward a suggestion of costs up to the early part of August before brief fees were paid, or became payable, and that amount was more than the sum which was fixed but not an awful lot more than the sum which was fixed as the appropriate amount.*
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> *6. In fact, the really stupid thing that was done was done by the defendant in that the defendant failed to carry out the recommendations of the ADR surveyor. Once he did that he put himself in the cart and he was always on a hiding to nothing. When you are on a hiding to nothing the best way, if there are costs involved, is to pay more than you think the other fellow should get in order to release yourself from the trap that you are in, especially a trap like the present which was created by the defendant's failure to carry out the recommendations of the surveyor.*

7. Having considered all these matters, having deprived the claimant of the indemnity costs, having deprived the claimant of the ADR costs, I consider that the settlement which was reached yesterday is one that the court can act upon and although the figure is not a figure of the courts I can look at the previous offers and say, first of all, that they do not meet the settlement and, secondly, that the settlement could have happened a long time before, but it did not. The claimant had a right to come to court and the claimant did come to court. The claimant is, therefore, entitled to his costs on the standard basis."

20. The judge recognised (rightly) that the figure of £11,750 was a commercial settlement figure, and that had the case gone on he might well have found the correct figure to be higher or lower than this sum. The sum arrived at by the parties did not therefore reflect the merits of the case. To use the words of the judge, it was an indication of "*lack of value of the case*" and "*of the fact that the parties can when pushed reach a figure*". In the present case the pushing came from the court itself.

21. The defendant conceded then (as now) that he should pay the costs up to the date of its Part 36 payment and offer of 13 May 2002, but contended that no order should be made in respect of costs thereafter. The reasons given by the judge for ordering the defendant to pay the costs of the entire action appear to have been (a) that it was on a hiding to nothing once it failed to carry out the recommendations of the ADR surveyor (paragraph 6), (b) the settlement figure exceeded the previous offers made by the defendant and (c) the settlement could have been achieved much earlier (paragraph 7).

22. The question of what order for costs should be made where the substantive proceedings have been resolved without a trial and where the parties have not agreed costs has been considered by the courts on a number of occasions. It is sufficient to refer to the decision of this court in **Brawley v Marczynski (Nos 1 and 2) [**2003] 1 WLR 813. The leading judgment was given by Longmore LJ. At paragraph 21 of his judgment he said this:

*"For my part, I find most helpful the principles which Scott Baker J deduced from the authorities in **R (Boxall) v Waltham Forest London Borough Council** (unreported) 21 December 2000. He set out those principles as follows:*

'(i) The court has power to make a costs order when the substantive proceedings have been resolved without a trial but the parties have not agreed about costs. (ii) It will ordinarily be irrelevant that the claimant is legally aided. (iii) The overriding objective is to do justice between the parties without incurring unnecessary court time and consequently additional cost. (iv) At each end of the spectrum there will be cases where it is obvious which side would have won had the substantive issues been fought to a conclusion. In between, the position will, in differing degrees, be less clear. How far the court will be prepared to look into the previously unresolved substantive issues will depend on the circumstances of the particular case, not least the amount of costs at stake and the conduct of the parties. (v) In the absence of a good reason to make any other order the fall back is to make no order as to costs. (vi) The court should take care to ensure that it does not discourage parties from settling judicial review proceedings for example by a local authority making a concession at an early stage."'

The principles distilled by Scott Baker J were in the context of judicial review proceedings. That explains the terms in which the sixth principle is couched.

23. The **Brawley** case was not, however, a judicial review case, and it is now clearly established that those principles apply to civil proceedings, whether of a judicial review nature or ordinary private law proceedings. In the **Brawley** case the first instance judge considered that the fourth principle identified by Scott Baker J was applicable. He held that it was obvious which side would have won if the substantive issues had been fought to a conclusion, and accordingly he made an order for costs in favour of one party. In the present case, however, the judge made it clear that he had no idea whether if the case had been fought to a conclusion the sum awarded to the claimant would have exceeded £11,750, or indeed any other sum. He certainly did not indicate whether the sum would have exceeded £10,750, the amount which had been offered by the defendants on 13 May 2002. The judge was not prepared to look into the substantive issues. The agreed basis on which the dispute as to costs had been submitted to him for resolution was that the underlying merits were irrelevant. This is hardly surprising since it would have been difficult, if not impossible, to reach a conclusion without hearing evidence and detailed submissions having regard to the nature of the issues to which I have

earlier referred. In those circumstances, in the absence of a good reason to make any other order, the fall back of no order for costs was inevitable.

24. In my judgment there was no good reason for not applying the fall back position in this case. I confess that I have difficulty in understanding the significance of paragraphs 6 and 7 of the judgment. The defendant may have been stupid and on a hiding to nothing in refusing to increase its offer above £10,750. But that cannot be a good reason for ordering it to pay the costs where a higher settlement figure is agreed solely on commercial grounds and at the behest of the court. It was the defendant's case that if the litigation had been fought to a conclusion it had good prospects of confining its claim to the value of the claim to a figure below £10,750. The judge acknowledged that it might well have been the case that he would have found the appropriate figure to be less than £11,750. As I have said, he expressed no view about the £10,750 for the very good reason that he was not asked to do so. Nor did he have the material to enable him to do so.

25. Mr Mulholland submits that the judge's view of the merits of the claim is discernible in the judgment. He points out that the judge had been the case manager for this litigation throughout. In 2001 the claimant had applied for summary judgment and the defendant had been given permission to defend conditional upon paying £10,000 into court and making a substantial payment towards the claimant's costs of the action to date. But that was before the expert's report had been obtained. More importantly, whatever view the judge entertained about the merits of the case at that earlier stage, he made it clear that his decision as to costs was not influenced by that view in any way. It follows that I cannot agree that it is possible to discern in the judgment any view held by the judge as to merits, still less a view as to the prospects of the claimant recovering more than £10,750 at the end of the trial. In reaching this conclusion, I have not overlooked the fact that in his first judgment on costs (that relating to the proceedings before Judge Hegarty) Judge Mackay did refer to there being "serious defects".

26. For completeness I should add that Mr Mulholland also relied on the fact that in reaching his conclusion the judge took into account the claimant's letter of 20 August 2002 and the defendant's response to it. It is true that at paragraph 5 of his judgment the judge referred to the letter of 20 August, but as I read the judgment, this reference is merely part of the history of the matter. It is not at all clear how, if at all, the judge took it into account in arriving at his decision. In my judgment that letter and the defendant's response to it was of little or no relevance. The central question was whether in circumstances where the court did not feel able to make an assessment of the ultimate outcome if the case had been fully fought out, there was a good reason for making any order other than no order as to costs. The letter of 20 August and the defendant's response could not, in my view, be such a good reason.

27. For all these reasons I would allow the appeal and would order the defendant to pay the claimant's costs up to the time for accepting the offer of 13 May 2002, that is to say 3 June 2002, and that thereafter there should be no order as to cost.

LORD JUSTICE BUXTON:

28. I agree that this appeal should be discharged in the way that my Lord suggests and for the reasons that he gives.

LORD JUSTICE SCHIEMANN:

29. I also agree that the appeal should be allowed and the cross-appeal dismissed. The parties are not to be blamed for not citing **Brawley** to the judge since the decision was handed down after the judge gave judgment, and the earlier case of **Boxall** which was cited to the judge was unreported. My reasons for agreeing with my Lord are those set out by him.
(Appeal allowed; Respondent do pay Appellant's costs assessed in the sum of £8,500).

MR RICHARD BRADLEY (instructed by Lees Lloyd Whitley, Liverpool L2 9TJ) appeared on behalf of the Appellant
MR MICHAEL MULHOLLAND(instructed by Hallows Associates, Flintshire CH7 1EN) appeared on behalf of the Respondent