UPPER TRIBUNAL (LANDS CHAMBER)

UT Neutral citation number: [2015] UKUT 0091 (LC)
UTLC Case Number: LRX/56/2014

TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

LANDLORD AND TENANT – service charges – estimated charges – management company failing to prepare audited services charge accounts and relying on company accounts and budgets when estimating sums payable – whether demands compliant with terms of lease – s. 47, Landlord and Tenant Act 1987 – service charges payable to management company – whether failure to include name of landlord in demands rendered sums payable to management company not due – appeal allowed.

IN THE MATTER OF AN APPEAL FROM A DECISION OF THE LEASEHOLD VALUATION TRIBUNAL FOR THE SOUTHERN RENT ASSESSMENT PANEL

BETWEEN:

PENDRA LOWETH MANAGEMENT LIMITED

Appellant

and

MR & MRS NORTH

Respondents

Re: Holiday Cottages at Pendra Loweth,
Falmouth
Cornwall

Before: Martin Rodger QC, Deputy President

Sitting at: Royal Courts of Justice, Strand, London WC2A 2LL
on
25 February 2015

Jonathan Seitler QC, instructed by Preston Goldburn Solicitors, for the appellant
Charles Knapper, of Fursdon Knapper, Solicitors, for the Respondents

The following cases were referred to in this decision:

London Borough of Southwark v Woelke [2013] UKUT 0349 (LC)
Princes House Limited v Distinctive Clubs Limited [2007] 1 P & CR DG20
Warrior Quay Management Co Ltd v Joachim LRX/42/2006 (Lands Tribunal)

DECISION

1. Pendra Loweth is a "holiday village" near Falmouth in Cornwall comprising 116 separate cottages set in landscaped grounds. The long leases under which each cottage is held provide for the appellant, Pendra Loweth Management Ltd, to manage the village and to provide services which are to be paid for by the lessees through an annual service charge.

2. On 12 March 2014 the First-tier Tribunal (Property Chamber) ("the FTT") held that estimated service charges for the years 2006-2013 had been demanded by the appellant in a manner which did not comply with the terms of the leases and so were not payable by the respondents, Mr and Mrs North, and other lessees. Charges for the years 2006-2010 were additionally found not to be payable because the demands relied on did not include the name and address of the landlord, as required by s. 47 of the Landlord and Tenant Act 1987.

3. With the permission of the Tribunal granted on 23 June 2014 the management company now appeals against both aspects of the FTT's decision.

The Lease

4. Each of the 116 cottages at Pendra Loweth is held under a standard form of lease. I was shown the lease of plot 81 which was granted in March 2003 for a term of 999 years. The parties to the lease were the lessee or tenant, a Mr Richards, referred to as the "Owner", the landlord, Mr Hick, described as the "Vendor", and the appellant, referred to as the "Management Company". The cottage itself is referred to as "the Property".

5. Only a peppercorn rent was reserved by the lease, but by clause 10 the Owner covenanted with the Management Company, the Vendor and the owners of the other cottages that he would pay to the Management Company on demand four specific charges by way of further or additional rent; by clause 66 these charges are recoverable in default of payment "as if the same were rent in arrears". The charges were referred to as the Estimated Service Charge, the Service Charge Adjustment, the Additional Estimated Service Charge and the Insurance Charge. The same charges are payable to the Vendor in the event of him performing the obligations of the Management Company, as clause 47 obliges him to do if the Company defaults.

6. This appeal is concerned with the Estimated Service Charge, which is defined in clause 7 of the lease as follows:

> "Such sum demanded on account of the Service Charge in respect of each Service Charge Period as the Management Company shall specify by notice in writing at

its discretion to be a fair and reasonable interim payment having regard to the Service Expenditure estimated by the Management Company under clause 29."

7. Clause 29 was a covenant by the Management Company requiring it:

> "To estimate the Service Expenditure in advance for each Service Charge Period and based upon such estimate to give notice to the Owners and to take all necessary steps to collect the amounts of Estimated Service Charge due on the due dates."

The expression "Service Expenditure" was defined to include all of the expenditure properly incurred by the Management Company in carrying out its obligations under the lease, including the list of specific items set out in the Ninth Schedule. The Service Charge Period was each calendar year.

8. The Service Charge itself is the Owner's agreed proportion of the Service Expenditure and the Service Charge Adjustment is any shortfall between that sum and the Estimated Service Charge paid by the Owner. By clause 49 any surplus of Estimated Service Charge may be carried forward by the Management Company into the next and subsequent Service Charge Periods. If such a surplus is carried forward it is to be held on trust for the Owner, and to be applied against future Estimated Service Charges at such time as the Management Company may determine.

9. By clause 30 the Management Company covenanted that it would keep proper books of account relating to the management of the village and would compute the charges due from the Owner within 90 days of the end of each Service Charge Period. By clause 31 it is required to procure an annual audit of the accounts and to provide a statement by a firm of independent chartered accountants verifying them as true and fair. A copy of the annual accounts is to be delivered to the Owner together with the accountant's statement within 90 days of the end of each Service Charge Period.

10. The Management Company may also demand an Additional Estimated Service Charge, in circumstances described in clause 54 as follows:

> "If (not withstanding the Management Company having endeavoured accurately to anticipate the amount of the Service Expenditure in accordance with clause 29) it shall appear to it that its estimate thereof is likely to be understated and the receipts by way of Estimated Service Charge insufficient to meet the expenditure to be incurred then it may demand from the Owner an Additional Estimated Service Charge computed by the Management Company as being that proportion of the amount understated which is attributable to the Property."

The relevant facts

11. At the hearing before the FTT it was common ground that the Management Company had failed to comply with its obligations to deliver service charge accounts

within 90 days of the year end as required by clause 30 or to procure an annual audit of the accounts in accordance with clause 31 of the lease.

12. No audited accounts had ever been produced and dissatisfaction with this practice was at the heart of the dispute. In its defence the Management Company pointed out that in 2008 there had been a vote in which the majority of the lessees who voted had agreed that they did not require the accounts to be audited. Mr Hick gave written and oral evidence to the FTT, which does not appear to have been challenged, of the practice adopted in relation to accounts, budgeting and the making of demands for Estimated Service Charges. That evidence was that a partial draft of the Management Company's accounts was produced each year in the autumn which was used together with previous accounts by the Company and its accountant in working out the budget for the forthcoming year. That budget was produced in about October and comprised an estimate of the income which the Management Company would receive (including income from the service charge), and an estimate of its expenditure (including the cost of providing the services). Copies of the annual budgets were said to have been sent to the lessees in each of the years under consideration and there is included in the appeal bundle a copy of a demand issued in December 2006 which is accompanied by the Management Company budget for 2007.

13. The 2006 demand is typical of the demands issued in the years 2006-2010. It bears the name and address of the Management Company, but not that of the landlord, Mr Hick. It is addressed to the lessee of each individual cottage and identifies that cottage by its address. Beneath the address appear the following words:

> "Maintenance for 2007 £1,650.00
> VAT £ 288.75
> Total due by 31 January 2007 £1,938.75
>
> Cheques payable to Pendra Loweth Management"

The Management Company budget which accompanied the demand includes under the heading "income" six separate items of which the first, "maintenance charge", is shown as the sum of £191,400. Other income includes takings from the café, bar, shop and other facilities in the village and the receipts of insurance claims. Under the heading "expenses" the budget is divided into 22 separate headings including café and shop purchases, insurance, general and water rates, ground maintenance and other smaller items in all totalling £234,240. The excess of income over expenses is described in the budget as "profit" and is shown as £22,460.

14. The annual demands remained in the same form until 2011. In the years 2011 and 2012 the demands were modified to include the name and address of Mr Hick, the landlord, and an explanation that each individual cottage was equally liable for the total anticipated "ground rent and maintenance charge" for the forthcoming year. The total sum taken from the budget supplied with the demand was then shown divided by 116, the number of individual cottages, to produce a contribution to which VAT was then added.

The Proceedings

15. On 7 September 2012 Mr Hick and the appellant began proceedings in the County Court against Mr and Mrs Leyser, the lessees of Plot 81, for the recovery of unpaid service charges for the years 2011 and 2012 and other sums totalling £5,426.82. Those proceedings were transferred to the leasehold valuation tribunal (the predecessor of the FTT) for it to determine what, if anything, was due in respect of the service charges.

16. After the transfer a number of further applications for the determination of service charges were made to the FTT under s. 27A, Landlord and Tenant Act 1985. Mr Leyser applied for a determination of his liability for the years 2006 and 2007 (the Leysers' liability for the years 2008, 2009 and 2010 had already been determined by arbitration). Mr Hick and the Management Company subsequently made an application of their own against Mr and Mrs Leyser in respect of charges payable in 2013. Finally, the lessees of a further eleven cottages commenced separate s. 27A applications for determination of their service charge liability for the years 2008-2013.

17. All of these applications came before the FTT at a hearing on 6 March 2014. The FTT had previously directed that the hearing would be confined to the issue of whether the service charges in issue were payable, having regard to the requirements of the leases and to s. 21 of the 1985 Act. Quantification of any charges found to be due was to be dealt with on a later occasion. The FTT additionally considered the effect of s. 47 of the Landlord and Tenant Act 1987 on the payability of the disputed service chages.

The First-tier Tribunal's decision

18. Before the FTT the main argument on behalf of the lessees was that the Management Company had failed to comply with clauses 29 to 31 of the lease which were said to be conditions precedent to the lessees' obligation to pay the service charges. The Management Company had simply issued annual demands for "maintenance", and had ignored its accounting obligations. Annual service charge accounts (as distinct from company accounts) had never been drawn up, balancing payments had never been requested or surpluses accounted for and the continuous process of basing each year's estimate on previous audited accounts had never been implemented.

19. The FTT was critical of the Management Company's deliberate policy of refusing to produce audited service charge accounts. At paragraph 42 of the decision it explained the difficulty which this policy created:

> "The whole problem here is that the Management Company does not just perform the covenants of the lease and keep accounts of that performance, audit those accounts and account in turn to the lessees; it is apparent that the Management Company has other areas of operation, including the maintenance of the club house owned by the Hick family and its part-rental…"

It went on, in paragraph 43, to take issue with the suggestion made by the solicitor acting for the Management Company that its accounts were "largely compliant with the Lease":

> "What is apparent is that this explanation cannot be correct because the Company turnover appears to include advertising, rental income, maintenance of the club house and other elements which do not appear to have any bearing on individual service charges… Apart from not using the terms used by the lease, there must be a real question as to whether the company was a business aiming to make a profit from the lessees or otherwise rather than a company standing in the shoes of the landlord to maintain the property in accordance with the requirements of the lease."

Although the FTT was critical of the Management Company and its advisors, it made it clear in paragraph 45 of its decision that there was no suggestion that anyone "has acted in a untoward manner, rather that there is a significant level of ignorance as to what is required for the protection of the rights of tenants."

20. The substance of the FTT's decision on the question of whether the estimated service charges were demanded in compliance with the terms of the lease was contained in paragraphs 49 and 50. It found that the demands for the estimated service charges were deficient in two respects, either one of which rendered them currently not payable.

21. The first of the deficiencies was that the evidence showed that the demands were in respect of Estimated Service Charges which did not follow an estimate of the Service Expenditure, but which were based instead upon the Management Company's own accounts. Those accounts were described as being "polluted" by all that the FTT had described in paragraphs 42 and 43 of its decision. The Company's operations were wider than the fulfilment of its obligations under the lease; there were links with another company to which loans had been made; there had never been an audit, which could have disentangled the service charge elements so that they could be estimated in accordance with the lease. There was, in short, "no realisation that the Company Accounts could not … be also the service charge accounts". The need for accuracy in the exercise of estimating the annual Service Expenditure was said to be clear from clause 54, which referred to the Management Company having "endeavoured accurately to anticipate the amount of the Service Expenditure in accordance with clause 29."

22. The second deficiency identified by the FTT was that the lease required a "continuous process" which had as its aim the protection of the lessees, but which the Management Company had deliberately ignored. Clauses 29, 30 and 31 ought to be read together rather than in isolation, and they described a series of necessary steps. By failing to maintain and audit service charge accounts, any estimated service charge levied by the Management Company must necessarily be deficient. The lessees were never put in a position where they could have any assurance that the Estimated Service Charge was a fair estimate of the service charges expected of them, "unpolluted" by loans between associated companies, director's remuneration, the costs of advertising, and other elements:

"Because there never was a balancing exercise conducted by the [Management Company] with the lessees, the [Estimated Service Charge] was their one opportunity to get it right, but the approach, involving the use of the Company accounts and a failure to audit even those accounts when elements of service charge expenditure could have been disentangled and assurances given, meant that it would never be right."

23. The F-tT also considered the lessees' submission that, for the years 2006-2010, the demands for estimated service charges had not contained the name of the landlord and therefore did not meet the requirements of s. 47 of the 1987 Act, with the result that the sums demanded were not payable.

24. Part VI of the 1987 Act applies to premises which consist of or include a dwelling and are not business premises (s.46). Section 47 concerns the content of a "demand" which, by s.47(4) is defined as meaning "a demand for rent or other sums payable to the landlord under the terms of the tenancy." By s.47(1) any demand given to a tenant of premises to which Part VI of the 1987 Act applies must contain the name and address of the landlord. The sanction for non-compliance is prescribed by s. 47(2), as follows:

"(2) Where –

(a) a tenant of any such premises is given such a demand, but

(b) it does not contain any information required to be contained in it by virtue of sub-section (1),

then (subject to sub-section (3)) any part of the amount demanded which consists of a service charge or an administration charge ("the relevant amount") shall be treated for all purposes as not being due from the tenant to the landlord at any time before that information is furnished by the landlord by notice given to the tenant."

25. It had been argued that s. 47(2) did not have the effect of rendering the charges irrecoverable because the demands for payment were made by the Management Company and the payments were due to it, rather than to the landlord. In paragraph 37 of its decision, the Tribunal gave the following reasons for rejecting that submission:

"My reasons for not accepting that submission are that the landlord can recover the sums as rent under clause 66 of the lease and has shown by his County Court claim against the Leysers that he does believe the sums are payable to him; indeed that clause is specifically relied upon in the pleadings. The lease (clause 8(j)) makes clear that the landlord can exercise his rights at his absolute discretion and he appears to have done so by commencing the County Court proceedings. He also controls the Management Company as the accounts make clear, although that was not a determinative issue."

The appeal

26. The Management Company sought permission to appeal both on the effect of section 47(2) of the 1987 Act, and on the effect of its failure to produce annual audited service charge accounts. The Tribunal gave permission to appeal on both issues but made that permission conditional on the Management Company producing annual audited service charge accounts for each year from 2007 to 2013. That condition was compiled with.

27. It is disappointing that the belated provision of audited service charge accounts has not enabled the parties to move on from the current debate over the payability of estimated service charges (most, if not all, of which were paid at the time they were demanded), and to concentrate on whether any credits or additional payments are required to be made or whether any adjustments are necessary to reflect the reasonableness requirements imposed by s. 19 of the 1985 Act.

28. Three issues were considered on the appeal:

(1) Whether the Estimated Service Charges were not payable because they were based on the Management Company's own budget for all of its activities, rather than on an estimate of the anticipated expenditure on items that could properly be included in the service charge. The parties referred to this as the "polluted demands" point in reference to paragraph 49 of the FTT's decision.

(2) Whether the Management Company's entitlement to recover the Estimated Service Charges was conditional on its compliance with clauses 29, 30 and 31 of the lease. The parties referred to this as the "continuum of practice" point, referring to paragraph 50 of the FTT's decision.

(3) Whether the Estimated Service Charges were irrecoverable for the years 2006 – 2010 because the name of the landlord had not been included in the demands, as required by s. 47(1) of the 1987 Act.

Issue 1: The basis of the estimate

29. The substance of the FTT's reasoning in paragraph 49 of its decision was that the Management Company had not estimated the Service Expenditure but had estimated the Company's own expenditure on all activities and that the demand for payment of the Estimated Service Charge was therefore defective.

The parties' submissions

30. On behalf of the Management Company, Mr Seitler QC submitted that although clause 29 of the lease required it to estimate the Service Expenditure in advance for the forthcoming period and to give notice to the leaseholders of the amount of the Estimated Service Charge based upon that estimate, there was nothing in the lease which imposed

any condition on the lessees' obligation under clause 10 to pay the charge on demand. That obligation applied whatever approach the Management Company had adopted in arriving at its estimate.

31. Mr Seitler made reference to the audited service charge accounts which had been compiled as a condition of permission to appeal and said that these showed a strong correlation between the company budgets and accounts on which the estimates had been based and the Service Expenditure now certified by the auditor as having been incurred in each year. The differences between the corresponding figures were very small and looked at over the period from 2007-2012, the margin of error was less than 1%. In practice, therefore, Mr Seitler submitted there had been no "pollution" of the annual estimates to any significant degree as a result of there being based on the Company's own accounts and budgets including all of its activities.

32. Secondly, Mr Seitler contended that an Estimated Service Charge based on expenditure which included items which were not themselves recoverable through the service charge ought not to be treated as wholly irrecoverable. In support of that proposition he cited a decision of Mr Jonathan Gaunt QC sitting as a Deputy Judge of the High Court in *Princes House Limited v Distinctive Clubs Limited* [2007] 1 P & CR DG20 (reported in summary form only).

33. In *Princes House* the landlord of commercial premises was entitled to demand on account service charges to meet expenditure which was to be "reasonably and properly incurred". The tenant disputed its liability to pay the on account charges on the grounds that the estimate was based in part on the costs of works which were unreasonable. The tenant argued that, unless the non-chargeable item was *de minimis,* the whole claim for on account charges should fail as the making of a reasonable estimate was, under the lease, a pre-condition of liability. The landlord submitted that the incorporation of non-chargeable items into the estimate should simply reduce the claim by the amount of those items.

34. In considering the effect on the claim of the inclusion of non-chargeable items in the estimate which underpinned the demand for on account service charges, the Deputy Judge had recourse to basic principles. First, when dealing with estimates it had to be appreciated that they would necessarily involve a degree of inaccuracy in both costing and specification. Secondly, the onus rested on the landlord to ensure that the estimate only included costs which were within the charging provision. Thirdly, a tenant could ask for a breakdown of the landlord's estimate from which he will be able to form a view as to what proportion was attributable to non-chargeable items. Fourthly, the purpose of providing for on account instalments of service charges was to ensure that the landlord was funded for the costs of providing services and not expected to recover that cost a year later. Finally, when a landlord sought to recover for non-chargeable items, he must provide the court with evidence as to what the estimate would have been had those non-chargeable items not been included. The Deputy Judge concluded:

> "In my judgment, therefore, if it is possible on the evidence to identify with some precision that part of the cost which has been incorrectly included in an estimate

upon which an on account demand for service charges has been based, then the court can determine the extent to which the estimate was reasonable and hold the tenant liable to make the payment on account of that amount."

35. Mr Seitler pointed out that, because the issue of compliance with the requirements of the lease had been considered by the FTT as a preliminary issue, without any investigation of whether individual items were properly included as part of the Service Expenditure, there had been no material on which to base an apportionment of the estimated charge into recoverable and irrecoverable elements. He did not accept that the expenditure incurred by the Management Company included items which were not properly part of the Service Expenditure but submitted that, whether they did or not, it was inappropriate for the FTT to hold that the entirety of the sums demanded were irrecoverable because they were based on estimates which included, or may have included, items which ought not to have been taken into account.

36. In his written argument on behalf of the lessees Mr Knapper submitted at some length that for the Estimated Service Charges to be recoverable it was necessary that they satisfy the requirements of section 20(b)(2) of the 1985 Act, which provides that relevant costs are recoverable more than 18 months after they were incurred only if lessees were notified in writing that they had been incurred and that they would subsequently be required to contribute to them. Mr Knapper made no reference to this point in his oral argument and it does not seem to me to assist him on the first issue in the appeal which turns on the proper construction of the Lease.

37. Mr Knapper emphasised that the Management Company was a trading concern for the landlord and that its activities were not restricted to performing the covenants under the lease. The definition of Estimated Service Charge required that it be "a fair and reasonable interim payment" and it was not fair or reasonable for the Management Company to use its own company accounts as a proxy for its service charge expenditure.

38. He also submitted that, for a demand to be compliant with clause 29 it should identify the charge as an estimated service charge and provide information on how it had been calculated. It was essential that lessees be given information about the costs incurred in the previous year to enable them to understand whether the sum was indeed "a fair and reasonable interim payment". The demands between 2006 and 2010 did not explain how they had been calculated and did not identify the sum claimed as an estimated service charge, referring to it only as "maintenance". The demands from 2011 onwards were better but still not good enough because although they showed that the sum demanded was arrived at by dividing a total figure for "maintenance/ground rent" equally among 116 lessees, it did not explain that it was intended as an estimated service charge. He submitted that no particular form of words was required, other than the sum demanded should be identified clearly as an estimated service charge.

Discussion and conclusion

39. The only description of the Estimated Service Charge contained in the lease is found in clause 7. The charge which the Management Company is entitled by clause 29

to demand and which the lessee covenants by clause 10 to pay is in the discretion of the Management Company and is to be "a fair and reasonable interim payment having regard to the Service Expenditure estimated by the Management Company under clause 29."

40. There is no need for the notice to state in terms that the sum demanded was a fair and reasonable interim payment having regard to the service expenditure estimated by the Management Company. Mr Knapper did not suggest that any particular form of words was required of a demand other than a statement that the charge was an estimated service charge. Even that seems to me to go further than the lease requires. The recipient of the notice referred to in clause 29 must be taken to be familiar with his own lease, and with his responsibilities under it. If in December 2006 a reasonable person knowing the structure of the lease received a demand for "maintenance for 2007" accompanied by a budget for 2007 showing expenses which it is intended to incur, I am satisfied that that person would readily understand that the sum being demanded was the estimated service charge for the forthcoming year, whether or not those words were used. The FTT rejected Mr Knapper's submission that the demands were defective in form and I consider it was right to do so.

41. I accept Mr Seitler's submission that the lease does not require as a pre-condition of liability to pay the Estimated Service Charge that the estimate must have been prepared by reference to a budget which follows strictly the categories of expenditure listed as Service Expenditure in the Ninth Schedule and excludes from consideration any other items. The sum itself is in the discretion of the Management Company. If the Company considers that the budget it has prepared for its own activities in the forthcoming year is a suitable approximation of its likely expenditure on service charge items in the same period, I can see no reason to interpret the lease as requiring some process of stripping out items of expenditure which may not fall strictly within Service Expenditure.

42. There was no allegation in this case of bad faith or deliberate overcharging by the Management Company and the FTT made a point of stating that nobody had "acted in an untoward manner". Where parties agree that one of them is to be trusted to make an estimate which the other is required to pay, subject to an account being taken at a later date, and the estimate is made in good faith, there seems to me to be little or no scope to challenge the estimate except by relying on s. 19(2) of the 1985 Act. Where a service charge is payable before the relevant costs are incurred, s.19(1) provides that no greater amount than is reasonable is so payable; there is therefore a statutory limit on estimated charges, even where they have been estimated in good faith. Where a deliberately inflated estimate has been submitted in bad faith or an entirely arbitrary figure has been chosen the contractual position is likely to be different, and it may be possible to say that, even without regard to the statutory cap on advance payments, the estimate is not payable in full; but that is not this case.

43. I appreciate that this approach is different from that taken by the Deputy Judge in the *Princes House* case but it seems to me to be more in keeping with the usual approach to the exercise of contractual discretion (see, for example, *Paragon Finance Ltd v Nash*

[2002] 1 WLR 685, and other authorities referred to in Lewison: *The Interpretation of Contracts,* at paragraph 14.11). I doubt that, in the residential context at least, there is likely to be much practical difference between the exercise contemplated in the *Princes House* case and an inquiry into the amount which it was reasonable to charge as an interim payment under s. 19(2) of the 1985 Act.

44. The lease does not require the provision of a budget and I reject Mr Knapper's submission that the lessee must be provided with sufficient information with the demand to enable him to satisfy himself that the sum demanded is a fair and reasonable interim payment. Good practice requires the provision of information but the lease does not make compliance with good practice a condition precedent to the lessee's liability to pay the Estimated Service Charge. In any event, the undisputed evidence of Mr Hick was that each demand was accompanied by an annual budget showing in some detail the total expenditure which the company intended to incur in the coming years.

45. I therefore consider that the FTT was wrong in its conclusion that the entirety of the Estimated Service Charge was irrecoverable because it was not shown to have been based on an estimate "unpolluted" by other activities of the Management Company. If the Tribunal took the view that the Estimated Service Charge was inflated by items which clearly could not form part of the Service Expenditure, then it would in due course have been open to it to reduce the charge by the application of the limitation in s. 19(2), of the 1985 Act, but it was not appropriate in my judgment simply to write off the whole of the Estimated Service Charge liability for the relevant period.

Issue 2: Whether the provision of certified accounts is a condition of liability for Estimated Service Charges

46. Mr Seitler argued that there was simply no justification for treating compliance with clauses 30 and 31 of the lease as conditions which had to be satisfied before the lessee's liability to pay the Estimated Service Charge arose under clause 10. The charge was to be an estimate of Service Expenditure in future. The obligation in clause 29 to prepare that estimate makes no reference to the accounts for previous years' expenditure forming the material on which the estimate is to be based. The position was, Mr Seitler submitted, indistinguishable from that considered by the Lands Tribunal (His Honour Judge Huskinson) in *Warrior Quay Management Co Ltd v Joachim* LRX/42/2006).

47. In *Warrior Quay* the management company (referred to in the decision as "WQMC") had failed to comply with an obligation to arrange for accountants to prepare an account and give certificates for the service costs each year. Rather than adopting the contractual pattern of estimated charges followed by a final account and a balancing charge WQMC had only ever demanded the estimated charges on account. It was submitted by the lessee that the absence of final accounts for any of the preceding years meant that he was not obliged to pay the estimated charges. At paragraph 25 the Tribunal said this:

> "It is clearly unsatisfactory that WQMC has failed to comply with its obligations… However, I am unable to read the lease as meaning that if WQMC has failed to

> comply with this provision then this automatically thereby proclaims that in respect of the service charge year to which the failure relates WQMC has lost the right to be paid any service charge whatever, such that the entirety of any sum paid on account must be dealt with on the basis that the leaseholder if either entitled to credit for this sum or to be repaid… the whole of the amount paid on account. I agree with Mr Bayne that for this dramatic result to ensue from a failure to comply in proper time with the obligation under the seventh schedule part 3, paragraph 2 would require clear words."

48. Mr Knapper submitted on behalf of the lessees that without the continuous process of annual accounting, auditing and estimating, the Estimated Service Charge demanded by the Management Company risked becoming entirely unrelated to the expenditure for which the lessees were properly liable. It was therefore essential for the Estimated Service Charge to be based on knowledge accumulated over the years from the audited accounts. Clauses 29, 30 and 31, together with clause 54, should therefore be treated as creating a condition precedent to the lessee's obligation to pay the Estimated Service Charge.

Discussion and conclusion

49. Although it should go without saying, the performance of the appellant in its role as Management Company has been so deficient in this case that it is worth emphasising that compliance with clauses 30 and 31 of the lease is not optional. As the FTT rightly pointed out, it is an essential safeguard for the lessees whose money the Management Company is entrusted to spend. The appellant justifies its admitted breach of those obligations on the grounds that, in the past, those lessees who have expressed an opinion have overwhelmingly agreed that the annual accounts need not be audited and have preferred that the expense of such an audit be avoided. While that may provide the Management Company with an answer to a complaint by those lessees, it cannot relieve it of its obligation to the remainder of the lessees each of whom, individually, is entitled to insist on the production of annual certified service charge accounts.

50. Nonetheless, a failure on the part of the Management Company to provide annual certified accounts does not seem to me to suspend the lessee's obligation under clause 10 to pay the Estimated Service Charge on demand. There is simply no connection between the performance by each of the parties of their respective obligations. The obligation to pay the Estimated Charge is not expressed as being subject to the production of the audited accounts, and the Management Company is in a position to make an estimate each year whether or not the accounts are available. There is therefore no practical reason to treat the production of the accounts as a condition of payment.

51. Clearly, at the commencement of the lease it would have been impossible for the obligation to pay the estimated service charge to be made conditional on the preparation of audited service charge accounts. In subsequent years, unless the provision of a notice of the sum payable was to be delayed until well into the year to which the sum related, it would be a practical impossibility for the Estimated Service Charge in one year to be

based on the audited accounts in the immediately preceding year. The absence of proper accounts for previous years may, of course, provide grounds for treating the estimate with circumspection or even suspicion; it may make it easier to justify a reduction under s. 19(2) on the basis that there is little to suggest the estimate is reasonable; but as a matter of contract the payment of the Estimated Charge is not conditional on the provision of audited accounts.

52. It follows that, in my judgment, neither of the reasons given by the FTT for finding the Estimated Service Charges not to comply with the terms of the lease was valid and I therefore allow the appeal on issues 1 and 2. That is sufficient to deal with the charges for the years 2011 and subsequently, but the FTT found a separate defect in the demands for the years 2006 to 2010 which I must now consider.

Issue 3 – Section 47, Landlord and Tenant Act 1987

53. I have already referred to the FTT's decision on the effect of non-compliance with s.47 of the 1987 Act at paragraph 25 above.

54. Mr Seitler took two points under s. 47 to neither of which did Mr Knapper have a persuasive answer. First, s. 47(1) requires that the name and address of the landlord be contained in "any written demand" given to a tenant of premises. A "demand" for this purpose is defined in s. 47(4) to mean "a demand for rent or other sums payable to the landlord under the terms of the tenancy." Section 60(1) of the 1987 Act contains a definition of "landlord" applicable to s. 47 as meaning "the immediate landlord"; there is no statutory extension of the expression "landlord" to include any person with the right to enforce the payment of a service charge (as there is in s. 30 of the 1985 Act).

55. In this case the obligation on the Owner or lessee under clause 10 of the lease was to pay the various charges to the Management Company. The obligation to pay the Vendor or landlord arose only if he had stepped in to carry out the Management Company's obligations following a default in performance of those obligations, as provided for by clause 47(a). There had been no such default. The sanction in s. 47(2) therefore had no application in this case, because the sums in issue are not payable to the landlord and the demand for their payment was therefore not a "demand" for the purpose of s. 47.

56. Alternatively, the only effect of the sanction, if it were to be applicable, would be to cause the charges not to be "due from the tenant to the landlord". Since the charges were due to the Management Company the lessee's obligation to pay them would be unaffected.

57. The FTT was persuaded otherwise because the landlord, Mr Hick, had joined in the County Court proceedings and in the applications to the FTT for determination of the charges. The covenants to pay the charges to the Management Company were made by the lessees with Mr Hick as well as with the Management Company and it may have

been for that reason that he was a party to the proceedings; alternatively his participation may simply have been an unnecessary over-elaboration. In either case it does not seem to me that Mr Hick's participation had any effect on the liability of the lessees to pay the charges to the Management Company and in particular it did not have the effect, as the FTT considered, of suspending the Company's entitlement to recover the charges on the ground of the non-compliance of its demands with s. 47.

58. I am therefore satisfied that the appeal must be allowed and the application remitted to the FTT for it to consider such issues as remain in relation to the lessees' liability to pay the Estimated Service Charges. I very much hope, however, that the parties will see the sense in reaching agreement on those issues and concentrating attention on the final accounts if any issues now arise in relation to them.

Martin Rodger QC
Deputy President

19 March 2015