LRA/9/2005

LANDS TRIBUNAL ACT 1949

Service Charges – Construction of Lease – Recovery of notional rent of Caretaker's flat – Presumption against recovery of sums exceeding expenditure – Clear words needed.

IN THE MATTER OF THE LEASEHOLD REFORM, HOUSING AND URBAN DEVELOMENT ACT 1993
AND IN THE MATTER OF 27/29 SLOANE GARDENS, LONDON SWI

BETWEEN **(1) THE EARL CADOGAN**
(2) CADOGAN ESTATES LIMITED **Appellants**

and

(1) 27/29 SLOANE GARDENS LIMITED
(2) WAYIL MAHDI **Respondents**

Re: House divided into Flats,
27 and 29 Sloane Gardens,
London SW1W 8EB

Before: His Honour Michael Rich QC

Sitting at Procession House, 110 New Bridge Street, London EC4V 6JL
on Thursday 30 March 2006

K.S.Munro instructed by Pemberton Greenish for the appellants
The First Respondent did not appear
Barry Denyer –Green instructed by Ronald Fletcher & Co for the Second Respondent.

The following cases are referred to in this decision:

Agavil Investment Co v Corner (CA 3rd October 1975)
Boldmark Ltd v Cohen [1986] 1EGLR 47
Cadogan v 44/46 Lower Sloane Street Management Company Ltd and Henry McHale (LRA/29 & 30/ 2003)
Gilje v Charlegrove Securities Ltd [2000] 3 EGLR 89
Gilje v Charlegrove Securities Ltd (CA) [2002] 1EGLR 41
Killick v Second Covent Garden Property Co Ltd [1973] 1WLR 658
Lloyds Bank PLC v Bowker Orford [1992] 2 EGLR 44

DECISION ON PRELIMINARY ISSUE

Introduction

1. This is the decision on a preliminary issue in an appeal by the freeholders against the decision of the Leasehold Valuation Tribunal for the London Rent Assessment Panel ("LVT") given on 26 November 2004, on the freeholders' application to determine the price to be paid by the first respondent, as nominee purchaser under the Act, for the freehold of six flats at the above address.

2. On 6th April 2005, the President gave permission to the appellants (to whom I will refer together as "the freeholders") for an appeal on two grounds as follows:

(i) Whether the headlessee [that is the second respondent] is entitled to recover a market rent for the caretaker's flat from the lessees [that is the holders of the leases of the six flats which were granted by the headlessee's predecessor in title, a majority of whom have formed the first respondent as the nominee company to claim the freehold]; and

(ii) the appropriate deferment rate to be applied to the valuation of the reversionary interests.

3. The appeal on the second issue is to be heard with a number of other appeals raising the same issue as to deferment rates, which are beginning on 5th June 2006. The first ground of appeal has therefore been heard as a preliminary issue.

4. The LVT's valuation of the price to be paid by the first respondent included £107,076 as being part of the value of the headlessee's interest attributable to his entitlement to recover from the lessees a market rent for the caretaker's flat. The effect of that entitlement upon the price to be paid and the two reversioners' share of that price is complicated. In trying to calculate it, I have discovered what I believe to be an arithmetical error in the LVT's determination which was neither canvassed in the course of the appeal nor is the subject of any appeal. The effect of the LVT's finding that the headlessee was entitled to receive a notional rent for the Caretaker's flat increases his share of the price, as I calculate it, by over £150,000. This arises partly because the price is some £78,000 higher, but almost as importantly because the freeholder's share of the marriage value is reduced. This has the effect that the headlessee's entitlement to a notional rent reduces the freeholder's share of the price to be paid by the nominee purchaser by some £75,000: hence the freeholders' appeal.

5. In these circumstances, it is the headlessee who has responded to the appeal on this preliminary issue, and the first respondent not only does not appear, but has written to the Tribunal to say that they accept the freeholders' grounds of appeal on this point.

Terms of the leases

6. The freeholders granted the headlease of the premises to the headlessee's predecessor in title on 15th February 1979. It was for a term expiring on 29th September 2045, at a ground rent rising by stages from £750 initially to £3,000 in the last 25 years. It was granted in consideration of a premium of £30,000 and a covenant (clause III) to carry out building works to convert the premises into flats and maisonettes in accordance with plans which were agreed in a memorandum dated 8th August 1981. These included the provision of a caretaker's flat in the front part of the basement of the premises.

7. By clause XI the headlessee covenanted not to use the premises

> "otherwise than as self-contained flats and/or self-contained maisonettes as shown on the drawings .. with a Caretaker's flat in the basement of the demised premises also where shown on the said Drawings."

And by clause XII (c) the headlessee further covenanted:

> "To provide for the demised premises throughout the term a full-time caretaker .. who shall reside in the Caretaker's flat rent-free as a licensee on a service basis .."

By clause XIX (d) underlettings are permitted only at rents which are not less than the rent reserved under the headlease apportioned over the flats and maisonette disregarding the Caretaker's flat.

8. It has been agreed that the underlease granted on 18th October 1989 in respect of Flat 2 is in a standard form. It was granted for a premium of £260,000 and at a ground rent of £125 a year rising to £500, for a term expiring on 26th September 2045 By clause 5(5)(p) of the underlease the lessor covenanted with his lessee to observe the covenants of the headlease.

9. The provisions as to service charge which the LVT had to construe were as follows:

(i) By clause 4(6) the lessee covenanted to pay the Service Charge in the manner provided in the Fifth Schedule

(ii) The Fifth Schedule defined the Service Charge as the due proportion of the Service Charge Expenditure which was defined in the following terms:

" "Service Charge Expenditure" means the total expenditure incurred by the Lessor in any Accounting Period in carrying out its obligations under Clause5(5) of this Underlease and all other costs expenses outgoings and matters incurred in connection with the management and running of the Building including without prejudice to or limitation of the generality of the foregoing the following:- [there follow thirteen sub-paragraphs to which I will return so far as is necessary]"

(iii) Sub-paragraph (iv) reads as follows:

> "The cost of employing maintaining and providing accommodation in the building for a caretaker including the provision of uniforms and boiler suits *and including an annual sum equivalent to the market rent of any accommodation provided rent-free by the Lessor* and general and water rates and gas and electricity charges in respect of such accommodation" [I have added the italics in order to assist reference back]

LVT's Decision

10. The LVT having set out these provisions referred to a Decision in the Lands Tribunal, to which I was a party, *Cadogan v 44/46 Lower Sloane Street Management Company Ltd and Henry McHale* (LRA/29 & 30/ 2003) ("the *McHale case*") in which it had been held that the intermediate landlord was not entitled to recover a notional rent for the caretaker's flat in those premises. They concluded however, that under the words of the present leases, the construction that a notional market rent was payable was "unavoidable" even though it might entitle the headlessee to recover a sum in excess of the costs of providing services.

11. The effect of that decision is that the headlessee is held to be entitled to charge the lessees a due proportion of the market rental value of the Caretaker's flat, even although he has neither forgone such rent nor expended it. He has not forgone the rent because he would not be able to let the flat out, without breach of the covenants in the headlease to keep it as a Caretaker's flat and to provide a rent-free Caretaker's flat, which covenants he has covenanted with the lessees in their underleases to observe. Nor, of course, has he expended any rent in order to provide the flat At most his predecessor incurred cost in providing it, but long before any current Accounting Period. It is on that point of construction that the freeholders appeal.

Approach to construction of service charge provisions

12. In the *McHale case* (sitting with Mr Rose FRICS*)* I said without reference to authority:

> "The underlease should not be construed as entitling the underlessor to recover as part of the maintenance charge [as the underleases in that case called the service charges] a sum in excess of the cost of providing the services, unless such construction is unavoidable."

13. I have, in the course of argument on this appeal, been reminded of an unreported decision of the Court of Appeal in *Agavil Investment Co v Corner* (CA 3rd October 1975), of which it appears from my decision in the Lands Tribunal and in the Central London County Court in *Gilje v Charlegrove Securities Ltd* [2000] 3EGLR 89, I was then provided with a copy of the transcript. Although a transcript was not available during argument in this case, much of what was said has been quoted in reported cases to which I was referred. Since the hearing I have been provided with a transcript of *Agavil,* thanks to the assiduity of Mr Denyer-Green.

14. In *Agavil* the Court of Appeal upheld the landlord's entitlement to recover a notional rent for a caretaker's flat. They found the case so clear that they did not call on the respondent to the appeal. Cairns LJ said :

> "When I come to construe this lease, on the face of it, it does seem to me that the loss to the landlords by giving up this flat for the occupation of a caretaker, and therefore being unable to let the flat to a tenant, falls reasonably within the words in paragraph 1 of the Schedule 'costs or expenses incurred by them in carrying out their obligations ' under Clause 3(b)(v) of the lease "

The sub-clause provided for "reimbursement of cost expenses and matters mentioned in the schedule". The Schedule was in three paragraphs:

> "1. The costs charges and expenses incurred by the Lessor in carrying out the obligations under Clause 3 of this lease" which included to "employ a caretaker for the Buildings whether resident upon the premises or otherwise"
>
> Paragraph 2 dealt with "outgoings" which were held not to arise.
>
> Paragraph 3 was "The expenses .. of the services provided by the Lessor .. in connection with .. the .. caretaker's accommodation"

15. In construing the words of the lease, the Court of Appeal refused to construe the word "reimburse" restrictively, and construed the words "costs" and "expenses" by reference to their context. On this basis Cairns LJ held that "reimburse" in the context of reference to sums "payable" as well as paid meant no more than "indemnify". "Incurred" was "an appropriate word to use in connection with any cost falling upon the landlord, including their forgoing an advantage they would otherwise have had." The context in which "costs and expenses" are used included "matters". In such context the fact that the lease specifically provided for accommodating the caretaker outside the building and in such case the recovery of the cost of doing so was, as Mr Neuberger QC said, in his decision in *Lloyds Bank PLC v Bowker Orford* [1992] 2EGLR 44 at p 47F, only a "supporting buttress for the conclusion .. already reached on the meaning of the words in the lease."

16. I sought to follow the Court of Appeal's approach to the construing of words in their context when I said in *Gilje* at p. 92G

> "I thought it wrong, in the context of the present underleases, to construe "monies expended" as being exclusive of costs borne in other ways"

Slade LJ in *Boldmark Ltd v Cohen* [1986] 1EGLR 47 at p. 49K drew attention to the fact that Goff LJ had described the meaning ascribed to the words in the *Agavil* lease as a "liberal meaning". The court nevertheless said:

> "the onus must fall on the [landlords] to show that under this particular lease the [tenants] have contracted to pay [the disputed item]"

17. When my decision in *Gilje* was considered by the Court of Appeal (reported at [2002] 1EGLR 41) they likewise referred to the decision in *Agavil.* Their approach to the construction of lease provisions such as the present was stated by Laws LJ at para 27 as follows:

> "The landlord seeks to recover money from the tenant. On ordinary principles, there must be clear terms in the contractual provisions said to entitle him to do so. The lease, moreover (my underlining) was drafted, or proffered, by the landlord. It falls to be construed *contra proferentem*."

He then said at paragraph 28:

> "At the end of the day, I do not consider that a reasonable tenant or prospective tenant, reading the underlease that was proffered to him, would perceive that para 4(2)(1) obliged him to contribute to the notional cost to the landlord of providing the caretaker's flat. Such construction has to emerge clearly and plainly from the words that are used. It does not do so. On that short ground, I would .. dismiss the appeal."

18. I think that in these passages, unless read carefully, Laws LJ may appear to be conflating two separate principles of construction. That is why I have underlined his use of the word "moreover" which indicates that he was not treating the requirement of clear terms as the same as the *contra proferentem* rule which as Mr Denyer-Green reminds me, by reference to the short judgement of Cairns LJ in *Killick v Second Covent Garden Property Co Ltd* [1973] 1WLR 658 at p.663, requires an ambiguity before it can be called in aid. Cairns LJ referred to the rule properly so-called in *Agavil* as follows:

> ".. it is a rule which only applies where, apart from it, considerations on one side or the other are evenly balanced, and I do not find that to be the position here."

19. Although Mummery LJ, in his judgement in *Gilje*, also used the expression "*contra proferentem"* he did so in supporting an approach to the construction of these clauses which in effect raises a presumption against recovery of charges unless the provision is in clear terms. He referred to a statement in the *Encyclopaedia of Forms and Precedents* relating to the drafting of provisions in leases for service charges as follows:

> "It is stated as follows:
>
> > The draftsman should bear in mind that the courts tend to construe service charge provisions restrictively and are unlikely to allow recovery for items which are not clearly included.
>
> Cited as authority are three cases, all decided in the 1980s. They include decisions of this court. .. The proposition is obvious. .. the proposition reflects a particular application of the general principle of construction in the *contra proferentem* rule."

20. I would therefore regard my use in *McHale* of the word "unavoidable" as merely a shorthand for the approach which we adopted in that case, which was not criticised in the present case and which, on review of authority appears to me to have been correct. I would however, for the purposes of this Decision, spell out the considerations more fully. The approach has I believe to be as follows:

(i) It is for the landlord to show that a reasonable tenant would perceive that the underlease obliged him to make the payment sought.

(ii) Such conclusion must emerge clearly and plainly from the words used.

(iii) Thus if the words used could reasonably be read as providing for some other circumstance, the landlord will fail to discharge the onus upon him.

(iv) This does not however permit the rejection of the natural meaning of the words in their context on the basis of some other fanciful meaning or purpose, and the context may justify a "liberal" meaning.

(v) If consideration of the clause leaves an ambiguity then the ambiguity will be resolved against the landlord as "proferror".

Conclusion

21. Mr Munro's first submission was that the headlease prohibited the recovery of a notional rent for the Caretaker's flat from the lessees. He was however unable to direct my attention to any provision of the headlease which had that effect. By clause XI (c) the flat is to be provided to the Caretaker rent-free. That does not preclude a provision in any underlease to charge a rent to the underlessee for the flat granted to the underlessee, fixed by reference to the market value of the Caretaker's flat. No more does it, in my judgement, prohibit the requirement of a covenant to pay the same sum under the name of service charge but recoverable as rent. On its proper construction there is nothing in the headlease to affect the question to be decided, save that it is part of the context under which the under-leases must be construed, that the headlessee is bound to provide a Caretaker and to accommodate him rent-free. Mr Munro accepted that such obligations could sensibly be imposed by the freeholders for estate management reasons, namely to avoid the risk of any caretaker obtaining security of tenure, but to maintain the standard of the premises for the benefit not only of the demised premises but also the surrounding area.

22. The question is therefore whether the provision in paragraph 1(1)(iv) of the 5th schedule to the underlease which I have italicised in setting it out in paragraph 9 above, clearly and plainly provides for the recovery of a notional rent being "an annual sum equivalent to the market rent of any accommodation provided rent-free by the Lessor" by way of "providing accommodation in the Building for a caretaker".

23. Mr Munro submits that clearly such sum is not "expenditure" and so should not be recoverable as "Service Charge Expenditure". I agree. He further submits that the enumerated thirteen paragraphs are expressed to be "without prejudice to or limitation of the generality of the forgoing" and could not therefore be taken to extend the meaning of "Expenditure". Mr Denyer-Green has satisfied me that this is a misconstruction of the definition which prefaces the thirteen sub-paragraphs. I agree that it can be properly understood by enumerating the categories of the definition as follows:

> " 'Service Charge Expenditure' means (i) the total expenditure incurred by the lessor in any Accounting Period in carrying out its obligations under Clause 5(5) of this Underlease and (ii) all other costs expenses outgoings and matters incurred in

connection with the maintenance management and running of the Building, including without prejudice to or limitation of the generality of the forgoing [the thirteen items]"

Thus the list is referable not, or not solely, to expenditure incurred in carrying out the obligations of Clause 5(5), but also "other costs expenses outgoings and matters". It may well be that an annual sum equivalent to the market rent is not an expense or outgoing that has been incurred, and not a cost incurred in the relevant accounting period, but it seems to me that if force is to be given to the words used, it must fall within the "matters .. including the cost of providing accommodation including [such] annual sum" I accept Mr Denyer-Green's submission that the thirteen enumerated items include at least one other item which is not an item of expenditure cost or outgoing. Sub-paragraph (ix) provides for a requirement to contribute to a reserve fund, which can be brought within the definition of "Service Charge Expenditure" only as "a matter incurred in connection with the maintenance etc of the Building".

24. Mr Munro none the less submits that I should not attribute what seems to me to be the natural meaning of "including .. the cost of .. providing accommodation .. including an annual sum equivalent to the market rent of any accommodation provided rent-free", because some other natural meaning can be attributed to it. The provision could, he suggests, have been inserted in order to enable the underlessor to recover a notional rent if a variation of the head-lease entitled him to charge a rent for the Caretaker's flat, so that if he continued to provide it rent-free he would indeed be incurring a cost in rent foregone. This suggestion seems to me to be entirely fanciful. Firstly the underlease has to be construed in the context of the headlease whose covenants, including the obligation to provide a Caretaker's flat rent-free the underlessor covenanted to observe. It would be inconsistent with such obligation to make provision in case that covenant were varied. Moreover it involves the assumption that the underlessee should act in an entirely uncommercial way, by agreeing to pay an increased service charge if, with no reference to him and with no benefit to him, the freeholders should agree to vary the terms of the headlease. That is not an obligation into which could be perceived that a reasonable tenant would enter.

25. I am forced to the conclusion that unless the words of the sub-paragraph are rejected they must be construed as entitling the second respondent to recover a notional rent of the Caretaker's flat as part of the Service Charge. That is the obligation that a reasonable tenant would perceive that he was entering into. There is no ambiguity and no need or right therefore to resort to the *contra proferentem* rule properly so-called, as opposed to what Mummery LJ called "a particular application" of it.

26. I should note that no submission was made that the notional rent would be irrecoverable by reason of s. 19 of the Landlord and Tenant Act 1985. Apparently the multiplier applied to the market rent determined by the LVT was agreed having regard to the possibility of difficulty, but it is to be doubted whether a notional cost would fall within the definition of "relevant costs" in s.18 of the Act.

27. Accordingly the appeal on this ground will be dismissed. The parties have agreed that there are no grounds on either side for an application for costs under s.175 of the Commonhold and Leasehold Reform Act 2002 and so there will be no order as to costs.

Dated 7 April 2006

His Honour Michael Rich QC