UPPER TRIBUNAL (LANDS CHAMBER)

UT Neutral citation number: [2013] UKUT 0471 (LC)
UTLC Case Number: LRX/86/2012

TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

LANDLORD AND TENANT – service charges – whether any credit for overpayment should be given to all leaseholders or just appellant – whether respondent's conduct amounting to breach of trust and/or RICS Code of Conduct – whether VAT on electricity supply to common parts of blocks of flats should be charged at reduced rate – whether Climate Change Levy chargeable on such electricity supply – respondent concedes case on administration charge and insurance premium – guidance given on whether another section 47 notice can be served and upon whether insurance premium was reasonably incurred – section 47 of Landlord and Tenant Act 1987 – section 20B of Landlord and Tenant Act 1985

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

BETWEEN

IAIN ROBERT MacGREGOR **Appellant**

and

B M SAMUELS FINANCE GROUP PLC **Respondent**

Re: Flat 23 and 29, Samuels Towers, Longhill Avenue, Chatham, Kent, ME5 7AT

Before: A J Trott FRICS

Sitting at: 43-45 Bedford Square, London WC1B 3AS
on 10 June 2013

Mr Trevor Cave, solicitor, for the Appellant
Andrew Dymond, instructed by Hurford Salvi Carr Property Management Limited, for the Respondent

The following cases are referred to in this decision:

Forcelux v Sweetman [2001] 2 EGLR 173
Johnson v County Bideford Ltd [2013] L&TR 18
London Borough of Brent v Shulem B Association Ltd [2011] EWHC 1663 (Ch)
Weston v Ian Frances as liquidator of Axiom Workshops Ltd (in liquidation) (LON/00AG/LSC/2011/0470)
Solitaire Property Management Company Limited v Holden [2012] UKUT 86 (LC)
Country Trade Limited v Noakes [2011] UKUT 407 (LC)
Skilleter v Charles (1992) 24 HLR 421

The following cases were referred to in argument:

Snook v London & West Riding Investments Limited [1967] 1 All ER 518
Warwickshire Hamlets Limited v Gedden [2010] UKUT 75 (LC)

DECISION

Introduction

1. This is an appeal by Mr Iain MacGregor ("the appellant"), the leasehold owner of flats 23 and 29 Samuels Towers, Longhill Avenue, Chatham, Kent ME5 7AT, against a decision of the Leasehold Valuation Tribunal of the Southern Rent Assessment Panel dated 2 March 2012 on an application made by BM Samuels Finance Group plc ("the respondent") under section 27A of the Landlord and Tenant Act 1985 ("the 1985 Act").

2. Permission to appeal was granted by the then President of the Upper Tribunal, (Lands Chamber), Mr George Bartlett QC, on 24 September 2012. The appeal was by way of rehearing and was limited to three issues:

(i) administration charges;

(ii) the cost of electricity to the common parts for the financial (calendar) years 2009 and 2010; and

(iii) the building insurance premium for the period 7 August 2009 to 6 August 2010.

3. At the hearing the respondent conceded that the administration charges, which concerned the costs of a debt collection agency called London Debt Collection Limited ("LDC"), were not payable. The appeal is therefore allowed on issue (i) which is not considered further in this decision except in relation to the preliminary issue raised by the appellant which is discussed at paragraph 13ff below.

4. The disputed electricity charges are £3,699 and £3,920 for 2009 and 2010 respectively.

5. The disputed insurance premium for the year 2009/10 is £7,549.32 (including finance costs at 3.5%).

6. The appellant's flats are two of 44 flats forming Samuels Towers, a development of two blocks (known as blocks A and B) built by Scammell Developments Limited ("Scammell") in the early 2000s. Originally there were 38 flats but some of these were subsequently subdivided into two. Both the appellant's flats are in block B.

7. The respondent took a charge against Scammell's freehold interest in May 2005. In May 2008 Scammell went into administration and the company was wound up. The

respondent became the mortgagee in possession and appointed Hurford Salvi Carr Property Management Limited ("HSC") as its managing agents.

8. The leases of flats 23 and 29 are in common form and provide for the payment of "Insurance Rent" which means the "Insurance Rent Percentage" (2.632%) of the cost to the landlord from time to time of paying the premium for insuring the "Buildings" (blocks A and B). This percentage was based upon the original number of flats in the blocks (38). It is agreed by the parties that the appropriate contribution is now 1/44 (2.273%) per flat.

9. The tenant must also pay the "Service Charge" which means the "Service Charge Percentage" (now agreed at 1/44 or 2.273%) of the "Annual Expenditure". Such expenditure includes all costs expenses and outgoings whatever reasonably and properly incurred by the landlord during a financial year in or incidental to providing all or any of "The Services".

10. "The Services" means the services, facilities and amenities specified in the Seventh Schedule to the lease and which the landlord covenants with the tenant to observe and perform. They include maintaining, repairing, renewing or replacing the common parts. They also include cleaning, lighting and heating the common parts and all entrances, halls, landings, staircases etc and other parts of the buildings used by the tenant and other occupiers.

11. Mr Trevor Cave, solicitor, appeared for the appellant and called Mr Iain MacGregor as a witness of fact.

12. Mr Andrew Dymond of counsel appeared for the respondent and called Mr James Douglas Thornton, Managing Director of HSC, as a witness of fact.

Preliminary issues

13. Mr Cave raised two preliminary issues at the start of the hearing:

(i) That the respondent had a conflict of interest and/or was in breach of trust. This submission was based upon the conflict of interest that Mr Cave said arose as a result of HSC, as managing agent, engaging (at least) two firms, LDC and Saracen Investments Limited ("Saracen") to carry out debt collection and building insurance services respectively. Mr Thornton was a director of HSC, LDC and Saracen and owned and controlled all three companies, either personally or through his wife. Mr Cave submitted that the facts gave grounds to believe that there had been a clear breach of the requirement imposed under section 42 of the Landlord and Tenant Act 1987 ("the 1987 Act") for the respondent to hold on trust the service charge contributions made by the leaseholders. Mr Cave also submitted that, as a firm of Chartered Surveyors, HSC was bound to carry out its duties as a

managing agent in accordance with the RICS Service Charge Residential Management Code (an approved code of practice under section 87 of the Leasehold Reform, Housing and Urban Development Act 1993). Mr Cave said that HSC had not complied with this Code in a number of respects. It had also failed to comply with the RICS's standards of ethical conduct with regard to the need to act with integrity and to avoid conflicts of interest.

(ii) That the ambit of the appeal should extend to the reimbursement to the service charge account of all monies that were shown not to have been reasonably incurred. Mr Cave submitted that the amounts to be credited should not be limited to the appellant's contribution. Mr Cave relied upon the Tribunal's overriding objective to deal with cases fairly and justly and submitted that Rule 2(2) of the Tribunal Procedure (Upper Tribunal) (Lands Chamber) Rules 2010 supported the view that the Tribunal should deal with the contributions of all the leaseholders of flats at Samuels Towers, nine of whom had been respondents at the LVT proceedings, and not just those of the appellant. Mr Thornton had conceded that the demand for the administration charge had been improperly made and that monies had wrongly been taken from the service charge fund. In those circumstances it was incumbent on the respondent to rectify the improper use of trust fund property without delay.

14. The first preliminary issue was mainly directed to the administration charge which, it is now conceded by the respondent, was improperly demanded and which is no longer contested in this appeal. It is therefore not necessary for me to consider the matter in that context although it remains relevant to the consideration of the charge for the building insurance premium and I return to the point below.

15. In response to Mr Cave's submissions on the second preliminary issue Mr Dymond submitted that the jurisdiction of the Tribunal was limited to the parties to the appeal and did not extend to those other leaseholders who were liable to the service charge. If the appellant succeeded in his appeal then the appellant's proportion of the insurance premium and/or the electricity costs would be credited to his account. The respondent accepted that the Tribunal would be concerned with whether the whole of the costs for the insurance premium and the electricity costs were reasonably incurred but it did not follow from that that any overpayment caused by a reduction in the total figure should be credited to the service charge account. The other leaseholders at Samuels Towers would doubtless be interested in the outcome and they could raise the issue with the respondent if they so wished. But this appeal was concerned solely with the appellant and the amount of his service charge.

16. The Tribunal's jurisdiction under section 27A(1) of the 1985 Act was to determine whether a service charge was payable. The Tribunal had no jurisdiction to consider an application made in respect of a matter that had been agreed or admitted by the tenant: section 27A(4)(a) of the 1985 Act. Other leaseholders in Samuels Towers might have agreed to the charges that were the subject of the present appeal and, if the appeal succeeded, they would not be entitled to any reduction due to section 27A(4)(a). There were eight other respondents before the LVT but none of them chose to appeal the

LVT's decision and so they were accordingly bound by it. Were they to seek to rely upon the Tribunal's decision then the decision of the LVT would prevent them from doing so. There would also be bizarre consequences where a flat had been sold after the relevant service charge became due. If the leaseholder at the time paid his proportion of, for instance, the insurance premium and then sold his flat, then, on the appellant's case, if the Upper Tribunal allowed the appeal the new flat owner would receive a windfall by way of a credit to the service charge account. That, said Mr Dymond, could not be correct.

17. Similar considerations applied to the jurisdiction of the Tribunal regarding the reasonableness of administration charges under Schedule 11 paragraphs 5(1) and 5(4)(a) of the Commonhold and Leasehold Reform Act 2002. Although an express concession was made in relation to the appellant's administration charges it did not follow that every other leaseholder would receive a similar concession; the respondent's entitlement to levy those charges would necessarily depend on whether an individual leaseholder was in arrears and, if so, by how much.

Decision on preliminary issue (ii)

18. Having heard the submissions of both parties I dealt with preliminary issue (ii) by an extempore judgment given at the hearing. In that judgment I determined that the jurisdiction of the Tribunal is limited to determining the amount payable to the appellant in this appeal under section 27A of the 1985 Act. The Tribunal does not have jurisdiction to consider the effect of that determination on the other leaseholders of Samuels Towers. Those other leaseholders must look to such remedy (if any) as may be available to them in the light of the Tribunal's decision. (The same reasoning applies to the determination of the administration charge under paragraph 5(1) of Schedule 11 to the 2002 Act).

Electricity charges for 2009 and 2010

Evidence for the appellant

19. Mr MacGregor said that the electricity costs rose by 65% between 2008 and 2010 which was far in excess of any electricity price increases during that period. The level of the charges was disproportionate to the electrical equipment installed and used in the common parts. Mr MacGregor produced tables and graphs showing the actual electricity usage of the common parts of both blocks A and B for each quarter of 2009 and 2010. He said that these showed that usage "fluctuated wildly", particularly for block A, and indicated "vastly increased usage" over the winter months. This increase was not attributable to heating since the common parts were unheated.

20. Mr MacGregor said that three pieces of evidence supported his claim that electricity had been extracted by another flat owner from electrical sockets located in the common parts:

(i) An examination of the electricity bills showed a huge difference in electricity usage between the two blocks. For instance block A had readings (not estimates) of 4,137 KWh and 6,534 KWh for the February and May quarters in 2010. The equivalent figures for block B were 2,222 KWh and 2,608 KWh respectively. To put these figures into context Mr MacGregor said that an average household with all of the usual domestic appliances used approximately 4,800 KWh annually.

(ii) A works order (reference 36163) issued by HSC to TJR Contractors on 10 December 2009 contained the following work description:

> "10.12.09 asked Trevor to cap of[f] or disconnect communal areas socket that tenants are using to get free electricity."

(iii) The lift in block B was inoperable during 2009 and there was no lighting in the stairwell and yet the electricity cost for the common parts was still £3,700.

21. Several of the electricity bills included VAT charged at 15% or 17.5%. Mr MacGregor said that the correct rate of VAT for the supply of electricity to residential communal areas was the reduced rate of 5%. The supplier, E.ON, also charged Climate Change Levy ("CCL"). Mr MacGregor said that this should not be charged on the supply of electricity to domestic properties.

22. Throughout 2009 and until September 2010, electricity was supplied by E.ON at electricity KWh usage tariffs of 15.96p (primary units) and 13.67p (secondary units). The supplier was changed to British Gas in October 2010 and the tariff rates were reduced to 7.63p and 4.13p respectively. Mr MacGregor said that he had raised this difference in the tariff rates as early as May 2009 at the previous LVT pre-trial review but the respondent had not acted to change the supplier for another 16 months. There was no evidence that the respondent had entered into a long-term supply agreement with E.ON. Mr MacGregor said that the electricity charges were therefore unreasonable on the basis of the excessive tariff rate as well as being based upon an unreasonable level of actual usage.

23. In its statement of case dated 30 November 2012 the respondent referred to British Gas having refunded a number of payments in respect of block A because of a defective meter. Mr MacGregor said that this was the first that he had heard of the matter. He did not accept that the respondent should be given time to work through the implications of the discovery of the defective meter. British Gas had refunded a total of £3,847.56 beginning in February 2012 and this amount should immediately be credited to the leaseholders who had suffered the financial loss. The respondent had not addressed the appellant's complaints about excessive usage, VAT or CCL. It was inappropriate to refer this issue to another LVT panel as suggested by the respondent. The appellant was not involved in those other proceedings.

24. Mr MacGregor said that the total electricity bill for each of the two disputed years should be limited to the 2008 figure, as shown in the accounts, of £2,323.

Evidence for the respondent

25. In the respondent's statement of case dated 30 November 2012 Mr Thornton referred to "further investigations" having taken place following the LVT hearing. British Gas had now changed the meter in block A and had given back "substantial credits". (At the hearing Mr Thornton said that his block manager had informed him that the electricity meters in both blocks had been changed.) But the respondent was still working through the net implications of these credits. Mr Thornton said that it was "too early to be able to see a pattern" and future electricity usage would need to be monitored in order to justify a claim for over charging. He said that the respondent needed time to collect evidence of usage following the change of meter so that it could claim against E.ON and British Gas if the credit already allowed was insufficient. He suggested that the whole picture of electricity usage from December 2008 onwards could be resolved as part of the other LVT proceedings relating to Samuels Towers that were already under way.

26. Mr Thornton explained at the hearing that the credits given by British Gas related to three invoices that had been raised during 2012. He submitted a spreadsheet that gave details of the electricity charges for the two blocks between 2008 and 2012. The three invoices were precisely matched in amount by the three credit notes. One invoice/credit note related to block A (£507.20), the other two invoices/credit notes related to block B (£932.35 and £2,408.01). Mr Thornton acknowledged at the hearing that the three credit notes were unrelated to the subject matter of the appeal, namely the electricity charges for the years 2009 and 2010.

27. Mr Thornton said that the cost of electricity in 2008, shown in the accounts as £2,323, did not represent the total electricity usage for that year. Prior to HSC's appointment as managing agent of Samuels Towers on 24 July 2008 the managing agent had been Platinum Gold Maintenance Ltd (Platinum). A director of Platinum was a Mr Noyes. Mr Noyes and his wife were also the lessees of ten of the flats within Samuels Towers. Mr Thornton said that it had been agreed by Mr Noyes at the earlier LVT hearing (held in July 2009) that Platinum would write off the shortfall between the service charge contributions and actual expenditure for the year ending 31 December 2008. That shortfall was shown in the accounts as £26,557 and related to the period January to July 2008. Therefore the amounts shown in the 2008 accounts for electricity to the common parts were in respect of the five months August to December 2008 when HSC were the managing agents.

Submissions for the respondent

28. Mr Dymond submitted that the actual electricity costs for the five months from August to December 2008 represented an annual cost, calculated on a pro rata basis, of some £5,000.

29. Mr Dymond said that there were two further pieces of evidence to support the respondent's contention that the 2008 accounts did not include the electricity costs for

the whole year. Firstly, Mr Thornton's comprehensive schedule of electricity payments which he produced at the hearing made it clear that the 2008 payments were only in respect of part of 2008. Secondly, the 2009 LVT decision had considered the estimated electricity costs for the year 2009 and referred to Mr Thornton's evidence based on the extrapolation of historic bills that an annual figure of £5,000 would be reasonable. This corresponded with the pro-rota 2008 figure based upon an actual cost of £2,323 for five months.

30. The fact that the accounts shown at page 190 of the trial bundle were headed "January through December 2008" was not relevant; the accounts only recorded the expenditure on electricity that had actually been incurred and charged to the service charge account in that year and did not signify that the cost for 12 months was £2,323. That figure should not be used as the basis for assessing the electricity charges for 2009 and 2010. That was a meaningless exercise.

31. There had been a consistent pattern of consumption over the years 2009 to 2012 with total costs ranging from £3,348 (2012) to £3,920 (2010). There was no evidence from the usage figures that electricity had been stolen. In any event the illicit use of electricity by tenants did not affect the fact that electricity was used and its cost incurred by the respondent. The appellant might have a claim against the respondent in negligence for failing to take reasonable steps to prevent the tenants using power points in the common parts, but any such claim fell outside the jurisdiction of the Tribunal.

32. There was a small argument "at the fringes" concerning VAT and CCL but Mr Dymond was "not so sure" that their inclusion on the disputed invoices was wrong. In any event they were only very minor amounts.

33. The fact that E.ON's tariffs were higher than those of British Gas did not mean that the earlier costs were not reasonably incurred. There was a range of charges that might be reasonable; see *Forcelux v Sweetman* [2001] 2 EGLR 173.

34. The appellant's comparison of the cost of the electricity to the common parts to that of supplying an average household was invalid because they were not comparable usages.

Submissions for the appellant

35. Mr Cave submitted that the 2009 LVT decision was entirely consistent with the appellant's case. It had allowed the estimated sum of £3,000 as being reasonable for the costs of electricity to the common parts. The actual figure had been £3,700. In reaching their decision they had regard to the 2008 cost. The write off by Mr Noyes was not relevant to the electricity argument.

36. There were issues of stealing associated with the 2009 figure and it had been increased to a degree as a result. The correct figure for each of the years 2009 and 2010 should be £2,323, the same as that for 2008.

Conclusions

37. I deal shortly with the two grounds upon which the appeal was allowed. Firstly, the LVT were wrong to say that the expenditure on the electricity to the common parts was "significantly lower [in 2010] than the preceding year." The figures before this Tribunal for 2009 and 2010 were £3,699 and £3,920 respectively. (The LVT gave the figure for 2010 as £4,388.) This point was conceded by Mr Dymond in his skeleton argument. Secondly, the LVT were wrong to say that there "was no actual evidence" that any abstraction of electricity by other tenants had occurred and that this was just an assertion by Mr MacGregor. The works order placed in evidence in page 78 of the trial bundle in this appeal refers to "communal area sockets that tenants are using to get free electricity". In my opinion that document constitutes evidence that supports Mr MacGregor's assertion.

38. I turn next to the three credit notes given by British Gas in 2012 amounting to £3,848. In his statement of case Mr Thornton attributed these credits to a defective meter in block A that had led to over charging. At the hearing he said that the credits had nothing to do with the amounts in dispute in this appeal, namely the electricity charges for 2009 and 2010. Mr Thornton's previous explanation that the credits related to a defective meter in block A appears to be wrong (at least in part) given that two of the credit notes, amounting to £3,340, were issued in respect of block B. The credit notes cancelled three invoices in the same amount issued by British Gas in 2012 and, as the present dispute concerns charges for 2009 and 2010, they appear to be nothing to the point.

39. The respondent invited me to defer a decision on this issue to allow another LVT that is currently constituted in respect of a separate application regarding Samuels Towers to determine this matter. I decline to do so given the respondent's statement that the credit notes are nothing to do with the issues in this appeal.

40. The 2012 LVT, when considering electricity usage for the common parts, said at paragraph 22 that the actual (annual) usage in 2009 (£3,699) was approximately £700 more than the estimate of £3,000 approved by the earlier LVT in 2009. The 2012 LVT assumed, and I agree, that this estimate was an annual figure, although there is some evidence to suggest that at times the annual budget was taken as £6,000. For instance, at page 58 of the respondent's bundle is a document headed "Service Charge Income & Expenditure – Budget Overview" for the period "January through December 2009". The budget for "Electricity – Common Parts" is shown as £6,000. This budget was sent to leaseholders by HSC on 25 November 2008. But on page 168 of the main bundle is another document with the same heading but for the period January 2009 through December 2010. The budget is divided into two columns, one each for January to December 2009 and January to December 2010. The budget for "Electricity – Common

Parts" is shown as £3,000 in each column. This document was sent to leaseholders by HSC in December 2009, primarily to inform them about the 2010 budget. In a separate document (main bundle page 167) a comparison is given of the budget against actual expenditure for the ten months January to October 2009. The actual expenditure for "Electricity – Common Parts" is shown as £2,649.49 against a budget of £2,500 (which is £3,000 per annum on a pro rota basis). I consider on balance that the budgeted expenditure for the electricity to the common parts in 2009 was the annual figure of £3,000 and not £6,000.

41. The actual expenditure on electricity to the common parts in 2008 is disputed. The appellant argues that it should be the amount of £2,323 that is shown in the accounts for that year. The respondent says that that figure represents only five months usage and that the balance was paid by Mr Noyes. I accept the respondent's argument on this point except for the fact that this sum represents seven months usage, rather than five, as can be seen from the relevant bills for 2008. The figure of £2,323 would be low by comparison with the usage of later years and its provenance has been explained on the spreadsheets that Mr Thornton submitted at the hearing and subsequently. Copy invoices from E.ON support the respondent's argument that the amount shown in the accounts was for the period 3 May 2008 to 13 December 2008. Those invoices amounted to £2,114. To this was added an accruals allowance of £209 for the period 13 December to 31 December 2008 giving a total of £2,323. On a pro rota apportionment basis the figure of £2,323 amounts to approximately £3,500 per annum. This compares with the actual cost of usage of £3,699 in 2009. I therefore do not accept the appellant's argument that the appropriate allowance for both 2009 and 2010 should be £2,323.

42. There is one direct piece of evidence that supports the appellant's contention that electricity was being stolen from the common parts of block A, namely the worksheet reference 36163 issued by HSC in December 2009. But if theft was an explanation of the high usage in block A I would have expected such usage to decline in the months following the implementation of the works order. In fact the electricity usage in block A increased sharply after the works were done and remained high until the last quarter of 2010.

43. There is a distinct difference in electricity usage between blocks A and B in 2010. In 2008 the usage of the two blocks was very similar for the period for which bills were produced in evidence, namely 7,194 KWh for block A and 7,272 KWh for block B. The usage of the two blocks was again very similar in 2009 at 9,959 KWh and 10,162 KWh respectively. The usage of block B in 2010 remained constant at 10,207 KWh but the usage of block A in 2010 was much higher, at 15,525 KWh, an increase of 56%. (That difference was even more marked in 2011 with the usage at block A rising to 27,256 KWh.) The explanations offered for this difference were (i) theft or (ii) a faulty meter.

44. Blocks A and B are essentially the same size and design and I would expect the electricity consumption of their common parts to be broadly consistent over time. In my opinion the electricity usage of block A in 2010 was anomalously, and unreasonably, high. I do not consider that the cost of such excessive electricity consumption was reasonably and properly incurred for the purposes of the lease and therefore did not

constitute part of the Annual Expenditure. On the facts this excess electricity was either stolen for use by an unidentified leaseholder without effective steps having been taken by the respondent to prevent it, or, if the meter was faulty, it was not consumed at all.

45. The average electricity usage for block A in 2009 and block B in 2009 and 2010 was 10,109 KWh. Allowing for a certain degree of variability I consider that a usage figure of 11,000 KWh was reasonable for block A in 2010.

46. Turning to the issue of VAT and CCL, E.ON charged VAT on four of their bills in 2009 and 2010 at either 15% or 17.5% and also charged CCL. It is probable that they also did the same in a fifth bill (dated 11 February 2009) for which no detailed breakdown is available but where the overall charge per KWh (17.8p) is almost identical to the 17.9p per KWh of the next bill (dated 2 June 2009) which included both VAT at the higher rate and CCL. Higher rate VAT and CCL were only charged in respect of block A. After October 2010 British Gas charged VAT at the reduced rate of 5% and did not include CCL.

47. After the hearing I asked the parties to make further submissions on this point and, in particular, to comment upon the relevant guidance given by OFGEM. This guidance is referred to at paragraph 7.20 of the RICS "Service Charge Residential Management Code", a copy of which was contained in the trial bundle.

48. The OFGEM document is entitled "The Resale of Gas and Electricity, Guidance for Resellers: Updated October 2005" and includes the following note about VAT and CCL:

> "…It is our understanding that no matter what the rate of VAT paid by the reseller [the respondent] to his own supplier, he or she may only include the lower rate (currently 5 per cent) in the charges made to the purchaser [the appellant].
>
> We also understand that liability to pay the Climate Change Levy is influenced by the VAT position. Even if the reseller has to pay Climate Change Levy he cannot pass it on to purchasers who only pay lower rate VAT."

49. The parties were also invited to consider HMRC Notice 701/19 "VAT: Fuel and Power". The appellant referred in his further submissions to the latest edition of this notice dated August 2012. This states at paragraph 2.1 that the reduced rate of VAT applies to supplies of fuel and power for qualifying use. "Qualifying use" includes domestic use. Supplies of fuel and power that exceed the de minimis limits (1,000 KWh per month) are for domestic use only if they are for use in a dwelling or certain types of residential accommodation. These types of accommodation include flats. Corridors, lifts, hallways and stairways in a residential unit are treated as part of the same residential unit.

50. In my judgment neither VAT at the higher rate nor CCL should have been passed on to the appellant and these elements of the electricity charges were not reasonably and

properly incurred and so were not part of the Annual Expenditure recoverable via the Service Charge.

51. There was also a significant difference between the rates charged by E.ON and British Gas for electricity. In its last bill dated 27 October 2010 E.ON were charging 15.96p per KWh for primary units and 13.67p per KWh for secondary units. The standing charge was 29.04p per day. In its first bill dated 2 November 2010 British Gas were charging 7.32p per KWh with a daily standing charge of 22.34p. I do not consider that this difference in cost necessarily means, as submitted by the appellant, that the cost of electricity supplied by E.ON was unreasonably incurred and that the respondent should have changed supplier sooner. There was no detailed analysis by either party of the electricity market in 2009 and 2010 so it is not possible to set the charges incurred into the wider market context. Although a landlord must be alert to changes in market prices and to the competitiveness of different energy suppliers it is not reasonable to expect a landlord always and immediately to change supplier so as to constantly follow the lowest tariffs even in the absence of a long term supply contract. There is likely to be a degree of inertia in changing a supplier and I do not consider, on the evidence, that the respondent was wrong not to have changed supplier before it did.

52. My conclusions may be summarised as follows:

(i) The electricity charges for block B for 2009 and 2010 were reasonably and properly incurred both for the purposes of the contractual service charge and having regard to section 19(1) of the 1985 Act.

(ii) The electricity charges for block A for 2009 were too high and were not reasonably and properly incurred because VAT at the higher rate and CCL were both wrongly charged.

(iii) The electricity charges for block A for 2010 were too high because of the VAT rate and the imposition of CCL. In addition the KWh usage was unreasonably high and this should have alerted the landlord to a problem, either of theft or of a faulty meter. The cost of excess electricity usage was unreasonably incurred and the cost should be adjusted by reference to an assumed usage of 11,000 KWh.

53. Making the appropriate adjustments for VAT, CCL and usage gives the following results:

Year	Block A	Block B	Total
2009	£1,857	£1,725	£3,582
2010	£1,457	£1,480	£2,937

54. The amount payable by the appellant is therefore determined at 1/22nd of the totals for the disputed years, namely £162.82 and £133.50.

Building insurance premium for 2009/10

55. Mr Dymond conceded, at the end of his cross-examination of Mr MacGregor, that, as with the administration charges, the disputed demand for the buildings insurance premium did not comply with section 47 of the 1987 Act and was therefore not yet payable. But he distinguished the demand for insurance from that for administration charges and he invited the Tribunal to go on to consider whether the costs of insurance were reasonably incurred.

56. Mr Dymond said that the reason for the respondent's concession on the administration charges was because those charges "were not payable full stop". He explained that the failure of the respondent to include the correct section 47 address on the earlier demands for service charges meant that at the time the administration charges were levied in respect of non payment, the appellant was not in fact in arrears, per section 47(2)(b) of the 1987 Act. So the administration charges were incorrectly demanded. However the situation with the insurance demand was "rather different". It was clear that the particular disputed demand did not comply with section 47. The effect of that non compliance was that that sum was not payable. But Mr Dymond submitted, relying upon *Johnson v County Bideford Ltd* [2012] UKUT 457 (LC); [2013] L&TR 18, that such non compliance could be "corrected retrospectively simply by the service of another notice".

57. Mr MacGregor said that the respondent could furnish him with as many new notices as it liked but, under section 20B of the 1985 Act, he was not liable to pay the insurance premium for 2009/10 where, as here, those costs were incurred more than 18 months before a demand for payment had been validly served.

58. The respondent's concession that the insurance demand did not comply with section 47 of the 1987 Act means that the appeal succeeds on this issue since in the absence of a valid section 47 notice the amount demanded, consisting of a service charge (namely an insurance premium), is to be treated under section 47(2):

> "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."

59. Although it is not necessary for the purposes of my decision to consider this issue further, in my opinion it would be unhelpful for me to stop at that point for two reasons. Firstly, I think it would be of assistance to the parties, and might prevent further litigation, were I to offer guidance about whether the respondent is prevented by the provisions of section 20B of the 1985 Act from serving a further, compliant, section 47 notice in respect of the insurance premium for 2009/10. Secondly, having heard the parties' evidence about whether the insurance premium was reasonably incurred I

consider that it would assist the parties, and again might prevent unnecessary litigation, were I to give my reasoned conclusions on the issue.

(i) The service of a further section 47 notice

60. Insofar as is material in the present appeal section 47 of the 1987 Act provides:

> "47. *Landlord's name and address to be contained in demands for rent etc*
>
> (1) Where any written demand is given to a tenant of premises to which this Part applies, the demand must contain the following information, namely–
>
> (a) The name and address of the landlord…
>
> (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 subsection (1)
>
> then…any part of the amount demanded which consists of a service charge or an administration charge…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.
>
> (3)…
>
> (4) In this section 'demand' means a demand for rent or other sums payable to the landlord under the terms of the tenancy"

61. Section 20B of the 1985 Act provides:

> "20B *Limitation of service charges: time limit on making demands*
>
> (1) If any of the relevant costs taken into account in determining the amount of any service charge were incurred more than 18 months before a demand for payment of the service charge is served on the tenant, then (subject to subsection (2)), the tenant shall not be liable to pay so much of the service charge as reflects the costs so incurred.
>
> (2) Subsection (1) shall not apply if, within the period of 18 months beginning with the date when the relevant costs in question were incurred, the tenant was notified in writing that those costs had been incurred and that he would subsequently be required under the terms of his lease to contribute to them by the payment of a service charge."

62. *Johnson* was very similar on its facts to the present appeal. In *Johnson* the LVT found that the landlord had failed to comply with the requirements of section 47, so that the amounts that it had found to be reasonable were not payable "pending service of valid service charge demands compliant in all respects with the law including section

47". It was the appellant lessees' case that a service charge demand which did not comply with section 47(1) was not a valid demand and could not therefore be treated as "a demand for payment of the service charge" within the meaning of section 20B(1). The appellants argued that the invoices sent to the lessees on which the landlord relied were not demands for the purposes of these provisions because they were not demands from the landlord but from the landlord's managing agent. The Tribunal, the then President, Mr George Bartlett QC, did not accept this argument. He said (at paragraph 8):

> "They were documents requiring the payment of sums due to the landlord under the terms of the tenancies, and the fact that they were sent by the landlord's management company did not mean that they were not demands. In the event that they were held to be demands, but deficient ones, Mr Knapper [for the appellants] submitted that there were two ways in which the deficiencies could have been corrected. One way was to serve notice under section 47. If that were done it might be that it would have some kind of retrospective effect. The other way was to serve fresh demands. It was this latter course that the landlord chose to take. But the fresh demand was not a notice for the purposes of section 47(2). Mr Knapper drew attention to clause 6(v) of the standard lease, which provides that the rules about serving notices in section 196 of the Law of Property Act 1925 applied to any notice given under the lease. I can see no reason at all, however, why the notice contemplated by section 47(2) should not be contained within a later demand, and I accept Mr Kokelaar's submission [for the respondent] that the demands of June 2011 were sufficient for this purpose."

63. The appellant in *Johnson* relied on the decision of Morgan J in *London Borough of Brent v Shulem B Association Ltd* [2011] EWHC 1663 (Ch) for his submission that a demand for the purposes of section 20B(1) must be a valid demand, so that the original demands, being invalid by reason of their failure to meet the requirements of section 47(1), could not constitute demands for this purpose. The invalidity with which *Shulem B* was concerned, however, was a contractual invalidity and was thus not one that was capable of retrospective correction. The President concluded (at paragraph 10):

> "An invalidity that arises by virtue of a failure to comply with the requirements of section 47(1) is by contrast one that can be corrected and can be corrected with retrospective effect. That is what subsection (2) provides. In my judgment, therefore, the lessees' contentions based on section 20B necessarily fail. The service of the demands in June 2011 had the effect of validating the earlier demands, and the amounts payable, therefore, are those set out in the schedule to the LVT's decision of 2 June 2011."

64. Applying the decision in *Johnson* to the facts of the present appeal I consider that the respondent would not be prevented in principle by section 20B from correcting the invalidity of the original demand for payment of the insurance premium with retrospective effect. I would reiterate that this conclusion, which has been reached without the benefit of detailed submissions, is only for the guidance of the parties when considering their future action and does not form part of this decision.

(ii) Was the 2009/10 building insurance premium reasonably incurred?

65. The issues in dispute (apart from whether the requirements of section 47 of the 1987 Act had been complied with) were identified in the parties' agreed statement of facts and issues as:

(a) whether the LVT wrongly accepted the evidence of Mr Thornton that each property covered by the block insurance policy was assessed individually;

(b) the substantial increase in the premium for 2009/10 compared with the premiums for the previous two years;

(c) the part played by insurance commissions paid to Saracen in these increased premiums; and

(d) whether the cost of direct debit payments and finance interest was being improperly charged back to leaseholders.

66. In the statement of agreed facts and issues the appellant contended that the correct level for the buildings insurance premium should be referable to the 2007/08 figure of £1,433 and that the difference between that figure and the premium for 2009/10 of £7,294 should be reimbursed to the service charge account. (I have already rejected the appellant's argument that any reimbursement should apply to all 44 flats at paragraph 18 above. Applying the appellant's argument to just his two flats would give a credit of £266.42 to the appellant.) During cross-examination it was put to Mr MacGregor that it was absurd for him to maintain that the insurance premium for 2009/10 should be the same as that for 2007/08. Mr MacGregor said in reply that the appropriate premium should be in the region of the two comparators that he had provided in evidence. These comparators were two quotes from the underwriting agency (Cobra) that had been used by the previous landlord prior to the respondent becoming the mortgagee in possession. The quotations were based on sums insured of £2.5m and £4.1m. The quoted premiums payable were £2,116 and £3,070 respectively with an effective date of December 2012. In his closing submissions Mr Cave said that the insurance premium for 2009/10 "should be much more in line with Cobra's figure based on [a sum insured of] £4.1m".

67. The respondent contended in the agreed statement of facts and issues that the appellant owed £332.62 in respect of this item. This was based upon an apportionment of the premium of £7,294. In fact the amount demanded from the lessees included a further credit charge of 3.5% for payment by monthly direct debit. The total demanded was £7,549 of which the appellant was required to pay £343.14.

The case for the appellant

68. The appellant argued that there had been a very large increase in insurance premiums between 2007/08, when insurance was effected by the previous landlord (£1,432) and 2009/10, when insurance was effected by the appellant (£7,549). That

increase amounted to 427% over two years. The increase was attributed to the commission paid to Saracen, a company owned by Mr Thornton and his wife. In his skeleton argument Mr Cave gave the example of an invoice for the insurance premium for the year 2008/09 (at page 441 of the trial bundle) in the sum of £7,318 which he compared with the premium shown for that year on the certificate of insurance in the sum of £3,800 (at page 87 of the trial bundle), implying that the difference represented the commission.

69. Mr Cave described the "layers" of insurance premiums being charged by Mr Thornton's companies as unwarranted and improper and that there were "clear failings" in Mr Thornton's use of trust monies. There were conflicts of interest in respect of the roles played by HSC and Saracen.

70. There was no evidence before the LVT to support Mr Thornton's assertion that the insurance premium was subject to individual risk assessment and market tested every two years. In a letter written by HSC to the appellant on 16 July 2009 the reason given for the increase in the amount of the premium was said to be:

> "…due to the current economic situation and the claims experience of the overall portfolio of which this property forms part, an increase in premium and excesses has been applied."

This indicated that the increases were because of the exigencies of a block policy rather than as a result of an individual risk assessment.

71. Nor did the claims history of the blocks support such a large rise in premiums. HSC wrote to a lessee in December 2009 explaining that there had been two insurance claims at Samuels Towers; one was made on 10 October 2008 for malicious damage to a lift that fell within the excess and the other was made on 5 August 2009 for malicious damage to a fire panel amounting to £625. The appellant said that only the first of these claims would have been reflected within the insurance premium for 2009/10 and that it did not justify the very large rise in the premium.

72. Mr Thornton had said that the commission paid to Saracen was to cover the costs of claims handling and the costs of (as it then was) Financial Services Authority ("FSA") compliance. But there was virtually no claims history and Saracen's FSA requirement should only have been as a nominee of Locktons, who were the appellant's insurance broker. The reason Saracen needed FSA regulation was because they were reselling insurance to the landlord with the lessees picking up the increased cost.

73. The respondent had argued that the increase in the insurance premiums resulted from an inspection and risk assessment undertaken by the insurer. But this inspection did not take place until 26 November 2009 which was more than four months after the premium for the year 2009/10 had been fixed. In fact on 16 July 2008 the respondent had set a draft budget for the year to August 2009 which showed the estimated insurance premium for 2008/09 as being £7,000. The increase in the premium was therefore unconnected to any risk assessment that the insurer conducted subsequently.

74. The increase in the sum insured/declared value for insurance purposes between 2007 (sum insured £1.7m) and 2008 (declared value £3.79m) was unwarranted. Mr MacGregor said that the former figure represented an average rebuilding cost of £39,000 per flat (assuming 43 rather than 44 flats) which had increased to £88,000 the following year. He said that this meant that the rebuilding cost was greater than the market value of the flats which ranged from £70,125 for a one bedroom flat to £80,750 for a two bedroom flat (allowing for the developer's 15% cash back offer).

75. The appellant objected that the respondent demanded the lessees' insurance contributions in full but then paid the premium by instalments by direct debit. This incurred finance charges which were improperly charged back to the leaseholders.

The case for the respondent

76. In its statement of case the respondent explained the increase in the insurance premium in 2009 as being "due to the condition of the building follow[ing] the insurer's (Aviva) survey…" Of particular concern were continuing reports of vandalism as HSC had explained to the three lessees who had queried the insurance premium. Samuels Towers was added to a block policy in July 2008 at which time the premium that was charged did not fully take into account all of the individual circumstances of the property. There had been numerous incidents reported that involved significant damage being caused to the buildings by residents and/or visitors, some of which were not dealt with by a claim against the insurance policy.

77. The appellant considered that the previous managing agent had under insured the buildings and so HSC's building surveyor had reassessed the sum insured to an appropriate level.

78. HSC's position on insurance commission was explained on a website that it had created to inform lessees about general management matters. The existence of the website was notified to lessees, for instance in the information letter sent out in December 2010. Mr Thornton gave further details of the insurance arrangements for Samuels Towers during examination in chief.

79. Mr Thornton explained that Saracen was his operations company. It had a reasonable balance sheet and so was used to handle insurance matters and to deal with claims. It therefore required FSA registration. In 2001 HSC was made an authorised appointee of Saracen. Saracen's role was to manage HSC's block insurance policy. Such a policy benefitted from economies of scale and should therefore have a lower premium than a stand alone policy. The block policy was discussed every year with Locktons.

80. Every two years the block policy was tendered in order to test the market. Locktons provided the details of each tender. The claims history of each block was taken into account and Locktons also produced a general market report. Locktons

evaluated each building in the block policy separately and would discuss their results with Saracen/HSC to determine how best to divide the premium. This was not always done on a pro rata basis. It was right that Saracen/HSC should declare their knowledge of individual buildings to Locktons, but in the first year (2008) that HSC were managing agents for Samuels Towers they did not know the property well enough which resulted in the insurance premium being too low. The next year, when HSC knew the property better, they made known to Locktons the problems with the buildings. There was a fair apportionment of the premium given the risks. Later in 2009 Locktons looked at the property themselves and that inspection confirmed what HSC had already told them.

81. Mr Thornton said that as managing agents it was important for HSC to be confident of the advice that it gave to its client landlord about insurance. For the last six or seven years HSC had worked with Locktons and had confidence in their abilities. He said that most client landlords were "happy to stick with them". They offered comprehensive policies that were as good as any and better than most.

82. Locktons were paid commission by the insurer. Mr Thornton said that the commission was shared with the landlord and the managing agent. There was "only one commission pot".

83. Mr. Thornton explained that one lessee owned about a third of the flats and had refused to pay service charges. This had resulted in two applications to the LVT with a third one pending. The reserve fund could not be used to pay the insurance premium and where the landlord was a mortgagee in possession there was little alternative other than to arrange financing for the payment of the premiums by regular instalments. If this was not done there would be insufficient cash to pay the insurance premium by a single payment. The landlord had assisted the lessees by allowing them to pay service charges quarterly rather than annually in advance as required by the leases. This had exacerbated the shortage of cash.

Conclusions

84. Much of the appellant's case was directed to what he saw as the inappropriate behaviour of Mr Thornton given that he was the managing director of HSC and owned and controlled, either on his own behalf or via his wife, other companies who were undertaking services on behalf of the respondent. The tone of the appellant's argument was accusatory throughout. This is exemplified in Mr Cave's skeleton argument where he states:

> "The Apellant notes Mr Thornton's apparent eagerness to close down argument on questions of breach of trust. That is not entirely surprising given the LVT decision in *Weston and others v Ian Frances as liquidator of Axiom Workshops Ltd (in liquidation)* (LON/00AG/LSC/2011/0470)."

Mr Cave then cites extracts from that case culminating in a reference to a finding of the LVT that HSC's use of the reserve fund was for a purpose which was "a clear breach of trust" and which bore, Mr Cave said, "self-evident" similarities to the present appeal.

But what Mr Cave did not do, as I pointed out at the hearing, was to give a fair and balanced representation of Mr Thornton's actions in *Weston*. I therefore asked Mr Cave to read paragraph 64 of the decision in *Weston* which I repeat here:

> "64. Mr Thornton is not a party to the application and he was not separately represented, although he gave extensive evidence. We have found it necessary to make a number of criticisms of his conduct of the management, but we wish to record that we have no doubts as to his decency and truthfulness. He found himself in a complex and confusing situation and it is clear that he worked extremely hard to try to find a solution which was in the best interests of all parties. Even with hindsight it is not easy to discern a fair solution to the many problems, caused largely by liquidation, and we do not necessarily blame him for his failure to solve them. It seems to us that both his failure and many of the difficulties which still exist were caused largely because he tried to be too helpful, particularly to the tenants, and that he was, perhaps understandably, without clear instructions from the liquidator, who is not a professional landlord. It is fair to say, too, that Mr Thornton was unlucky that the deal whereby the tenants would purchase the freehold for £1 and take on responsibility for the roof, which he assumed to be on the point of completion, unexpectedly foundered. It seems to us unfortunate for everyone that it did, because it was, in our view, an eminently sensible one."

85. This Tribunal is concerned to establish whether the disputed service charges were reasonably incurred. It is not its function to police alleged breaches of the professional and ethical standards of the RICS. In *Solitaire Property Management Company Limited v Holden* [2012] UKUT 86 (LC), an appeal concerned with the use of reserve funds, His Honour Judge Huskinson expressed puzzlement that the LVT, having concluded that the amounts which had been demanded by the landlord for the reserve funds were reasonable, considered that it should then examine the reserve funds provision in the way that it did. Judge Huskinson continued (at paragraph 32):

> "…The LVT did not consider the reserve funds position for the purpose of deciding a question arising under section 27A as to how much was payable as service charge in any given year. In another case it could become relevant, for the purpose of deciding how much was payable by way of service charge by a tenant in a particular year, to decide questions regarding the status of money in the reserve funds. For instance if in a particular year a tenant argued that less should be demanded for a particular heading of expenditure because reserve funds should have been drawn upon for some or all of that head of expenditure, then the situation regarding such reserve funds could become relevant to decide this question under Section 27A – including consideration (if the landlord's case was that there was no money in the reserve fund to draw upon) of the question of whether the landlord had improperly spent the reserve funds in some unauthorised manner. However in a hypothetical case such as that the situation regarding the reserve fund is something which needs to be decided for the purpose of deciding a question expressly within the LVT's jurisdiction, namely how much is payable by way of service charges by a tenant in a particular year. In the present case the LVT do not purport to suggest that any decision they reached in respect of the reserve funds impinged upon how much was payable by way of service charges in any of the years which were under consideration by them. Instead the LVT's consideration of this reserve fund's position appears to have been an entirely

> separate consideration as to whether the trust funds held by the appellants had been wrongly depleted by them and whether the appellants should in consequence make good to the new trustee (i.e. the new manager, Mr Bulmer) any monies wrongly used from the reserve funds. This question was separate from and did not involve consideration of any question arising under Section 27A as to how much was payable by any tenant by way of service charges in any particular service charge year.
>
> 33. In my judgment the LVT had no jurisdiction to embark upon this breach of trust inquiry in circumstances where such inquiry was not necessary to decide a question arising under section 27A."

The appellant submits that the present appeal is an example of where it is relevant to the issues before the Tribunal to investigate questions of the respondent's managing agent's conflicts of interest and breach of trust. As Mr Cave said in his skeleton:

> "…in this case…it is the Appellant's contention…that the amounts which were demanded for work undertaken by LDC on debt collection and the level of insurance premiums charged by Saracen are excessive. The unreasonable nature of these charges is intimately connected with the fact that, so far as the Appellant is aware, all these companies operate out of the same premises and there is no real and effective distinction between the companies."

86. I do not accept that the evidence establishes an intimate connection between Mr Thornton's (and his wife's) control of a number of companies involved with the management of the property and the level of service charges. In *Country Trade Limited v Noakes* [2011] UKUT 407 (LC) His Honour Judge Gerald said (at paragraph 5):

> "5. There is one preliminary observation to make. The Decision is redolent with contentious language casting implied aspersions on the probity of the management arrangements reached between the Appellant and Robbert Limited ('Robbert'). Those arrangements, described variously as being a 'device' or 'incestuous' by the LVT, arose out of commonality of ownership and directorship of some of the legal entities involved about which the Appellant had been open and frank throughout.
>
> 6. Unless, which is not the case here, it is asserted that the management arrangements were a mere 'sham' *i.e.* an arrangement which disguised the true relationship or agreement between the parties, there is nothing in principle objectionable to a management company such as the Appellant employing a company it owns or is involved in to provide services: see *Skilleter v Charles* [1991] 24 HLR 421.
>
> 7. Whilst such arrangements may well justify a rigorous scrutiny of the fees being charged and the services provided, sight must not be lost of the fact that (a) the question is whether or not the costs are reasonable within the provisions of section 19 of the Landlord and Tenant Act 1985 and (b) there is nothing objectionable to such arrangements – unless, as I have said, which was not the case here, it is alleged they were a mere "sham" or artifice. It is therefore preferable to

avoid the use of such descriptions not least because it may give the impression that the tribunal is not focused on what is or are the real issues – 'reasonableness'".

I accept Mr Dymond's submission that the appellant has not established that the arrangement of Mr Thornton's companies constitutes a sham in this regard. The appellant's concerns about Mr Thornton's motives have been fuelled by what he sees as a lack of transparency about the relationship between HSC, LDC and Saracen. This led the appellant to investigate at length the company register information and company accounts of Mr Thornton's companies. That exercise diverted attention from the sole issue in dispute, namely whether the service charges were reasonably incurred. In my opinion there was not such secrecy in the company arrangements as to justify the level of accusatory suspicion expressed by the appellant in this appeal. Such arrangements are not objectionable in themselves; but I agree with Judge Gerald's caveat that they invite rigorous scrutiny of the charges which are demanded.

87. A comparison between the insurance cover effected in 2007/08 with AXA via Cobra Underwriting Agencies Ltd and that placed by HSC with Aviva for 2008/09 and subsequent years is difficult given that the full details of the respective cover is not known. But the following observations may be made:

(i) Apart from the sum insured/declared value for the buildings the level of cover was broadly similar in respect of public/property owners liability (£5m) and the contents of the common parts (£20k).

(ii) The basis of settlement under the AXA policy is not stated. Under the Aviva policy the basis of settlement was "buildings day one (non adjustable)" with a 50% uplift applied to the declared value to give the sum insured. The declared value is the cost of rebuilding the property on day one of the policy period while the percentage uplift is an allowance for inflation to take account of increased costs during the policy period and the construction period. In my opinion a 50% uplift is a full allowance to apply to the declared value of the appeal property. For instance if building costs were increasing by 5% per annum it would take approximately 8.5 years before the declared value amounted to the sum insured. There is therefore a significant margin of safety in the size of the uplift. This is illustrated by the fact that in July 2009 HSC increased the declared value from the 2008 figure by index-linking it at 1.3%. The greater the size of the uplift the greater the premium will be, although the premium rate for the inflation provision is likely to be considerably less than the rate for the initial declared value.

(iii) There was a substantial increase in the sum insured between 2007/08 and 2008/09. Under the AXA policy in 2007 the figure was £1,493,903. In 2008 the declared value (before the 50% uplift) was increased under the Aviva policy to £3,790,000 and thereafter it was "index linked" – although the basis of indexation was not defined. There was a nil indexation in July 2010.

(iv) One way of analysing the insurance costs over the years is to compare the premium (including tax) per £100 of cover (building costs/declared

value). (This is only a robust estimate given the lack of detailed information about each policy.) This analysis gives the following results:

2007/08: 9.6p (AXA)

2008/09: 10.0p (Aviva)

2009/10: 19.0p (Aviva)

2010/11: 18.4p (Aviva)

2012: 8.5p (Cobra: estimate on sum insured of £2.5m with an effective date of 27 November 2012)

2012: 7.5p (Cobra: estimate on sum insured of £4.1m with an effective date of 27 November 2012)

These results suggest that the increase in the premium was not just due to the increase in the rebuilding cost/declared value. There were other factors as well, for instance the inclusion of the property on a block policy; a general increase in premium rates throughout the industry (as evidenced by Locktons market review in 2009); a greater risk profile for the appeal property; or a change in the amount of commission reflected in the premium. (In fact the increase in the premium in 2009/10 is buffered by an increase in the amount of the excess which was doubled at that time from £250 to £500.)

(v) The respondent submits that it was not until 2009, once HSC had been managing the property for a year, that its true risk profile became apparent. At that time the premium was adjusted to allow for the problems at the property. Those problems would not necessarily be reflected in the claims history since, as HSC's website states, the managing agent would not necessarily want to risk increasing the premium by making a claim where the damage was small. Mr Thornton said that HSC could not withhold information about the condition of the building from Locktons and that once this information had been disclosed to them Aviva made their own inspection in November 2009, the result of which was to confirm HSC's views about the condition and risk profile of Samuels Towers.

(vi) The amount of commission earned on the insurance policy was not stated in terms. In answer to my questions Mr Thornton said that it varied between 15 to 25% and that it was probably at the upper end of the scale in this case. The only other direct evidence on the point was contained in a letter dated 7 July 2010 from HSC to the respondent stating that "this year" (2010/11) HSC were reducing "the amount of commission we earn by 16.7%".

88. The basis of the insurance policy effected by Cobra for the year 2007/08 is not stated in terms. It does not appear that it was on the same basis as that effected by HSC with Aviva since there is no reference on the Cobra insurance schedule to a buildings day one basis of settlement with an uplift. The Cobra schedule refers to the sum insured but not to a declared value.

89. It is important with a buildings day one policy that the declared value is accurately assessed at each renewal. Mr Thornton said that the declared value was assessed by a building surveyor. Mr MacGregor challenged the resultant figure per flat as being too high because it was as much as the historic purchase price (allowing for a cash back arrangement that Mr MacGregor said was not in fact honoured). There is no simple relationship between the market value of the flats in Samuels Towers and the cost of their reinstatement. Value is not a good proxy of cost and I do not place weight on Mr MacGregor's evidence on this point. There is no cost evidence to show that the appellant's declared value for insurance purposes was excessive. That declared value was then adjusted for inflation at the renewal date over the next two years. I consider such a method of adjustment to be reasonable.

90. The most significant increase in the premium occurred in 2009/10 when the premium nearly doubled from £3,800 to £7,294. That increase, unlike the previous increase in 2008/09, cannot be attributed to a large rise in the declared value/sum insured. The appellant argues that the increase is attributable to commission being paid to HSC and/or Saracen. (Mr Cave referred to copy invoices which he said showed the amount of commission being charged. The invoice to which he referred at page 441 of the trial bundle described the demand as being for insurance for 2008/09. But the date of the invoice is 7 August 2010 and in my opinion it relates to the certificate of insurance from Aviva for the year 2010/11 on page 227 of the trial bundle. The description in the document on page 441 appears to be wrong.) The respondent says that the increase in premiums was due to HSC's better acquaintance with the risks of the property which were confirmed by the insurer's subsequent inspection of the property in November 2009, leading to the production of a list of mandatory risk improvements.

91. The appellant relies upon two quotations from Cobra, issued on 23 November 2012, and based upon sums insured of £2.5m and £4.1m respectively. Again the basis of settlement is not stated and it appears that it was not on a day one basis because in both quotations the sum insured and the declared value are said to be the same. I do not find those quotations to be helpful, particularly as they had an effective/renewal date of 12 December 2012.

92. The commission that is earned by HSC/Saracen on the insurance policy is not clearly stated in the evidence, although Mr Thornton gave some indication of its operation and amount during examination in chief and in answers to the Tribunal. The payment of commission is a common commercial practice and, as I have already noted at paragraph 85 above there is nothing objectionable in principle to connected companies being involved in the management of a property provided the relationship between them is not a sham. I am not persuaded that there is such a sham in this case.

93. In my opinion the appellant effected buildings insurance in a reasonable manner, using a recognised insurance broker, undertaking an insurance valuation to determine the appropriate declared value, index-linking that value, carrying out a detailed risk assessment that was confirmed by the insurer and market testing the insurance every other year. I consider that the amount of uplift was high at a time when the rate of building cost inflation was low and that this gave a very comfortable margin of safety.

But the amount of the inflation allowance would be a relatively small part of the insurance premium, the main cost of which would be in respect of the declared value. Any savings by reducing the percentage uplift are therefore likely to be small.

94. I accept the appellant's reasons for incurring finance on the payment of the insurance premium by regular instalments (see paragraph 82 above).

95. In my opinion the 2009/10 insurance premium of £7,549.32 (including finance costs at 3.5%) was reasonably incurred and had it been necessary for me to decide the matter I would have dismissed the appeal on this issue.

Determination

96. The appeal is allowed in respect of administration charges and the insurance premium. No service charge is payable in respect of the administration charge. No insurance premium is payable for the year 2009/10. The appeal is allowed in part in respect of electricity charges. The service charge payable by the appellant in respect of such charges is determined in the sum of £162.82 for 2009 and £133.50 for 2010.

Dated 21 October 2013

A J Trott FRICS