

WHERE ARE WE NOW ON SERVICE CHARGES?

by

John Furber QC

John specialises in all aspects of the law of real property, with an emphasis on property developments and commercial leases. He also has many years of experience in the law and practice of town and country planning and compulsory acquisition of land. Since 1982, he has been editor of Hill and Reman's Law of Landlord and Tenant and is now general editor of that work.

He is recommended in the Legal 500 and Chambers UK as a leading silk in the field of property litigation.

'Head and shoulders above most for landlord and tenant work', 'a barrister with a soothing manner in court whose relaxing style wins him many backers'. Chambers UK

Recommended for his 'practical approach and academic nous' and 'advisory work and development cases'. Legal 500

1. Introduction

- (i) Obligations to pay service charges are contained in the lease and are thus contractual. In the case of residential leases the contractual obligations are heavily overlaid with statutory provisions, intended to be protective of the Lessee. These provisions do not apply in the case of commercial leases, so the obligation to pay must be found in the contractual provisions of the lease, properly construed. It is usually implicit that the service charges payable are only those which are fair and reasonable (see Finchbourne v. Rodrigues [1976] 3 All ER 581), but this derives from the true construction of the lease.

- (ii) The commercial purpose of service charge provisions is obvious and was described by Mummery LJ in Universities Superannuation Scheme Ltd v. Marks & Spencer Plc [1999] 1 EGLR 13 as follows:

“The purpose of the service charge provisions is relevant to their meaning and effect. So far as the scheme, context and language of those provisions allow, the service charge provisions should be given an effect which fulfils rather than defeats their evident purpose. The service charge provisions have a clear purpose: the landlord who reasonably incurs liability for expenditure in maintaining the Telford Shopping Centre for the benefit of all its tenants there should be entitled to recover the full cost of doing so from those tenants and each tenant should reimburse the landlord a proper proportion of those service charges”.

- (iii) Whatever the broad commercial purpose, the contract (the lease) must in the end prevail. The scheme of payment and recovery contained in the lease must be analysed in every case. The general principle stated by Mummery LJ is rightly qualified:

“So far as the scheme, context and language of those provisions allow....”

2. **Leonora Investment Company Ltd v Mott Macdonald Ltd [2008] EWCA Civ 857**

- (i) This case demonstrates that the first question to be asked when considering whether a service charge is recoverable is very simple: “What does the lease say has to happen before the tenant is obliged to pay service charge?” (Tuckey LJ para. 17).
- (ii) The service charge provisions in the lease considered in this case were entirely conventional. The tenant covenanted to pay additional rents, including a “service charge” which was payable in accordance with Part 2 of the Schedule of Services. In short, Part 2 provided as follows:
- in Paragraph 1, the service charge to be paid by the Tenant shall be such fair proportion of the actual or anticipated

Service Costs for each Service Charge Year, to be assessed by the Landlord or its Surveyor according to a reasonable and proper basis for appointment

- in Paragraph 2, the Landlord may send a notice to the Tenant of its estimate of the anticipated Service Costs and the service charge applicable to the Premises for the coming service charge year and the Tenant shall pay such estimate of the service charge by equal quarterly payments in advance
 - in Paragraph 3, the Landlord will send to the Tenant a statement of the actual service costs and service charge for each Service Charge Year as soon as practicable after the end of such year; the Tenant will then pay any balance due or if there has been an overpayment the excess will be credited by the Landlord by way of set-off against the next instalment of service charge due.
- (iii) The Service Charge Year in this case ended on 24 December 2002. The dispute related to the recovery by the Landlord of costs incurred between May and September 2002 (about £263,000 for works to the common parts of the office block).
- (iv) The tenant paid service charges for the relevant year, based on an estimate, as demanded. On 31 January 2003, the landlord's agents issued credit notes to the tenant, because the payment of estimated service charges had exceeded the actual service charge, as supported by schedules of actual service charge costs incurred.
- (v) The schedule of actual service costs did not include the cost of the works to the common parts referred to above. These had been separately demanded (as "extras") by an invoice dated 15 January 2003. This was not paid by the tenant as it contended that these costs were only recoverable under the procedure laid down by paragraph 3 of the Schedule. This issue was tried as a preliminary issue. The tenant also

contended that a large proportion of the amount claimed was for improvements for which it was not liable and that the costs claimed were not reasonable and proper. These contentions were not considered by the trial judge or the Court of Appeal.

- (vi) The claim made by the invoice was not made in accordance with Part 2 of the Schedule. Ingenious arguments were put forward to support the proposition that this “did not contain a definitive or exclusive regime for imposing the obligation to pay service charge on the tenant” (para. 15). These were rejected. Tuckey LJ was not concerned with the question as to whether there was any “condition precedent” to the tenant’s obligation to pay service charges; he was solely concerned with “the contractual route down which the landlord must travel to be entitled to payment” (para. 22).
- (vii) None of this is surprising (but see the decision next considered). Perhaps more important is the support given by Tuckey LJ for the trial judge’s conclusion that it might be open to the landlord to issue a revised statement under Paragraph 3:

“No one has challenged the judge’s conclusion that it was open to the landlord to issue a revised statement. Nor would I. Provisions of this kind should not be seen as procedural obstacle courses. Businessmen dealing with one another often make mistakes and there is no scope for saying that the provisions in this clause only gave the landlord one opportunity to get it right, I say nothing about the landlord’s prospects of being able to get it right even now, because we have not heard argument about this” (para. 23).

- (viii) As paragraph 3 of Part 2 of the Schedule does not provide that the Landlord’s statement shall be final and binding, it is easy to see why the Landlord may be able promptly to correct a mistake in it. But what if any money demanded pursuant to paragraph 3 has been paid; is the Landlord then able to correct a mistake and claim more money years after the original payment? This might seem unjust; hasn’t the obligation to make the payment been satisfied? These questions are raised but not answered by the observations quoted above. However, some general guidance can be found in the USS case.

3. **Universities Superannuation Scheme Ltd v. Marks & Spencer Plc [1999] 1 EGLR 13**

- (i) There is no citation of case law in the judgment of Tuckey LJ in Leonora; it was presumably considered irrelevant to the construction of the lease before the Court. By contrast, the trial judge in Leonora spent some time in considering the USS case, before distinguishing it.
- (ii) In that case, the Defendant (tenant of a unit in Telford Town Shopping Centre) was obliged to pay “a sum in respect of the service charge.... calculated in accordance with the Fifth Schedule”.
- Paragraph 2 of the Fifth Schedule required “the amount of the service charge” to be certified in writing to the Tenant annually by the Landlord at the end of the Landlord’s Financial Year “in manner thereafter provided”.
 - Paragraph 3 dealt with the contents of the certificate (a summary of all the expenses and outgoings incurred by the Landlord during its Financial Year in carrying out the services).
 - Paragraph 4 dealt with the calculation of the amount of the service charge payable by the Tenant; this was done by reference to the rateable value of the demised premises as a proportion of the aggregate of the rateable values of all the properties in the shopping centre benefiting from the services.
 - Paragraph 5 dealt with the payment of the service charge. This was in conventional form. These were provisions for payments in advance in each year and then for payments following the issue of the certificate:
“As soon as practicable after the date of the Service Charge Certificate the Landlord shall send to the Tenant an account of the Service Charge payable by the Tenant for the Landlord’s Financial Year in question due credit being given

therein for all interim payments made by the Tenant in respect thereof and upon the furnishing of such account there shall be paid by the Tenant to the Landlord the amount of the Service Charge as aforesaid or any balance found payable....”

- (iii) The Defendant paid all the amounts of service charge demanded by the Claimant for the years ended 31 March 1992 and 31 March 1993. It was later discovered that these had been incorrectly calculated by USS, who had taken the applicable rateable value to be £348,600, whereas the appropriate rateable value was £848,600. Further payments were sought, but the Defendant refused to pay, contending that it was obliged to pay the service charge certified and demanded and on payment of that sum had satisfied its contractual obligations. This contention succeeded at first instance, but failed on appeal.
- (iv) Mummery LJ emphasised that the service charge obligation of the Defendant must be determined as a matter of the construction of the lease, although he immediately thereafter made the general observations quoted in paragraph 1 above.
- (v) His reasoning in allowing the Claimant’s appeal was as follows:
- The obligation was to pay the service charge calculated as in the Fifth Schedule, not as certified there. There was no provision that any certificate should be binding, final or conclusive.
 - The method of calculation was set out in paragraph 4. The payment of the lesser sum incorrectly calculated was not a performance by the tenant of the contractual obligation to pay the sum correctly calculated.
 - The only reference to a sum payable by the tenant was in paragraph 4; there was no such reference in paragraphs 2 and 3, and the certificate in paragraph 2 identified only the

total amount of expenditure by the Landlord in the relevant year.

- (vi) In both this case and Leonora (obiter) it appears that mistakes in demands for service charges can be put right, so that the tenant may have to pay more in respect of a particular period, having satisfied the demand initially made. In this case, unlike Leonora, there was no need for the landlord first to make any revisions or corrections in the procedure initially adopted; it had a simple contractual right to ask for more (the correct amount). This was not a case where relief from the consequences of a mistake was required.

4. **Fluor Daniel Properties Ltd v. Shortlands Investments Ltd [2001] 2 EGLR 103**

- (i) As mentioned in paragraph 2(v) above, one of the defences raised in the Leonora case – and not yet considered by the Court – related to the nature of the works carried out by the Landlord. Issues as to whether works are “improvements” or “repairs” often arise in service charge cases and reference must then be made to numerous landlord and tenant cases on the meaning of “repair”.
- (ii) A conventional service charge clause will require the tenant to pay for expenditure incurred by the landlord in performing its covenant to repair. A clause of this sort was considered in the Fluor Daniel case.
- (iii) In that case, the landlord’s repairing covenant contained the following elements:
- A covenant to “uphold maintain repair amend renew cleanse and redecorate and otherwise keep in good and substantial condition and as the case may be in good working order and repair” certain elements of the building and its apparatus, plant and machinery,

- There was a proviso to the clause stating that the landlord could add or vary any services that it should reasonably deem desirable for the more convenient or efficient conduct or management of the building.

The service charge clause provided for the recovery of expenditure incurred by the landlord under its covenant to repair and the right of recovery was extended to include the cost of “maintaining or improving services” (clause 7(2)(e)). Finally, there was a provision that the landlord would use its best endeavours to maintain the “Annual Service Cost” at the lowest reasonable figure consistent with due performance and observance of its obligations.

- (iv) The landlord claimed the costs of removing and replacing “plant” (EG for the provision of air conditioning). It was held that it was not entitled to recover such costs; such expenditure was unreasonable and a programme of repair, at a lower cost, was appropriate.
- (v) The judge (Blackburne J) reached the following conclusions on issues of law.
 - (a) If work was to fall within the ambit of the repairing covenant for these purposes it was necessary to show that the item in question suffered from some defect (some physical damages or deterioration or, in the case of plant, some malfunctioning) such that repair, amendment or renewal was reasonably necessary. Further, the condition of the item in question must be such as to be no longer reasonably acceptable, having regard to the age, character and locality of the premises, to a reasonably minded office tenant of the kind likely to take a tenancy of the building.
 - (b) The proviso to the repairing covenant was confined to the rendering of services, not to the means of rendering them

(EG the plant) and did not itself justify the recovery of expenses incurred in improving the plant.

- (c) Clause 7(2)(e) did not entitle the landlord to recover costs incurred on works to plant that were in proper working order, when such works was not reasonably required to maintain the service and would not improve it.
- (d) The landlord was in principle free to decide how it would discharge its repairing and other obligations provided it acted reasonably, (see Plough Investments Ltd v. Manchester City Council [1989] 1 EGLR 244). However, following Holding & Management Ltd v. Property Holding & Investment Trust plc [1989] 1 WLR 1313, the judge reached this important conclusion:

“The works – IE the standard to be adopted – must be such as the tenants, given the length of their leases, could fairly be expected to pay for. The landlord cannot, because he has an interest in the matter, overlook the limited interest of the tenants who are having to pay by carrying out works that are calculated to serve an interest extending beyond that of the tenants. If the landlord wishes to carry out repairs that go beyond those for which the tenants, given their more limited interest, can be fairly expected to pay, then, subject always to the terms of the lease, the landlord must bear the additional cost himself.” (p. 111).

- (e) The judge rejected a contention that it was reasonable to replace an item of plant at the tenant’s expense merely because it had reached the end of its “recommended lifespan”.
- (vi) Each case, of course, turns on its facts, but the principles set out at (d) above seem to be of general application. Most importantly, it appears the length of the tenant’s lease has to be taken into account in considering what is “fair and reasonable”, within the Finchborne principle referred to at the beginning of this paper.