UPPER TRIBUNAL (LANDS CHAMBER)

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TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

LANDLORD AND TENANT- service charges – non-compliance with contractual procedure – time not of the essence – provision of incomplete information – failure to account on annual basis – choice to account separately for major works – possibility of serving revised documents – content of revised demands

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

BETWEEN THE LONDON BOROUGH OF SOUTHWARK Appellant

and

DIRK ANDREA WOELKE Respondent

Before: The Deputy President, Martin Rodger QC

Sitting at: 43-45 Bedford Square, London WC1B 3AS
on 27 June 2013

Philip Rainey QC and *Michael Walsh* instructed by the London Borough of Southwark for the appellant
Clare Parry instructed by Housing and Property Law Partnership, solicitors, for the respondent

The following cases are referred to in this decision:

Universities Superannuation Scheme Ltd v Marks & Spencer plc [1999] L&TR 237
Leonora Investment Co v Mott Macdonald [2008] EWCA Civ 857
Morshead Mansions Ltd v Mactra Properties Ltd [2013] EWHC 224
Wembley National Stadium Ltd v Wembley (London) Ltd [2007] EWHC 756

The following additional cases were referred to in argument:

Investors Compensation Scheme v West Bromwich Building Society [1998] 1 WLR 896
Rainy Sky v Kookmin Bank [2010] 1 WLR 2900
West Central Investments v Borovik [1977] 1 EGLR 29

DECISION

Introduction

1. This is an appeal, by way of review, against a decision of the Leasehold Valuation Tribunal for the London Rent Assessment Panel ("the LVT") given on 2 November 2011 in a dispute over the entitlement of the appellant landlord to recover service charges totalling £4,039.26 from the respondent long leaseholder. The charges were for the respondent's contribution towards the cost of major works undertaken by the appellant. The LVT decided that because the appellant had billed the service charges for the major works separately from more routine recurring service charges it had not followed the terms of the lease, and that as a result the sum claimed was not yet payable.

2. The LVT granted permission to appeal to this Tribunal, not, it emphasised, because it thought its decision might be wrong, but because the lease is in a form used extensively by the appellant and the approach to billing of which the LVT disapproved had been adopted as a matter of routine. Although I was told that its approach to billing has now been revised, the appellant regards this appeal as being of continuing significance to the management of its residential estates.

3. The issues raised by the appeal concern the strictness with which contractual procedures for the recovery of service charges must be observed, and the degree of flexibility available to a landlord to deviate from those procedures either deliberately or inadvertently. It is therefore convenient to begin with the terms of the lease, before considering how those terms were implemented by the appellant.

The Lease

4. The respondent is the leaseholder of a flat in a block of 42 flats on the appellant's Tabard Gardens Estate in London SE1 ("the Estate"), on which there are 19 similar blocks with a total of 888 flats. The respondent's lease was granted by the appellant in 1990 and was assigned to the respondent in 1999.

5. The lease is for a term of 125 years and is in the standard form adopted by the appellant for long leases granted under the "right to buy" provisions of the Housing Act 1985. It includes covenants for the appellant to provide services and for the respondent to contribute towards their cost through a service charge.

6. By clause 2(3)(a) of the lease the leaseholder covenanted:

> "To pay the Service Charge and the Capital Expenditure Reserve Charge contributions set out in Part I and Part II of the Third Schedule hereto respectively at the times and in the manner there set out."

7. The covenants on the part of the appellant (referred to in the lease as "the Council") are at clause 4 and included obligations to keep the structure and exterior of the flat and of the building in repair and to provide various services listed elsewhere.

8. The Third Schedule to the lease is divided into two parts. Part I, entitled "Annual Service Charge", provides machinery for the lessee to contribute towards the costs incurred annually by the Council in complying with its covenants. Part II, entitled "Capital Expenditure Reserve Charge", authorises the accumulation of a reserve fund to meet major capital expenditure. Part II of the Third Schedule has not been implemented by the appellant and the parties agree that it is not relevant to the issues in this appeal.

9. The relevant provisions governing the annual service charge in Part I of the Third Schedule are as follows:

> "1(1) In this Schedule "year" means a year beginning on 1 April and ending on 31 March
>
> 1(2) Time shall not be of the essence for service of any notice under this Schedule
>
> 2(1) Before the commencement of each year (except the year in which this lease is granted) the Council shall make a reasonable estimate of the amount which will be payable by the Lessee by way of Service Charge (as hereinafter defined) in that year and shall notify the Lessee of that estimate
>
> 2(2) The Lessee shall pay to the Council in advance on account of Service Charge the amount of such estimate by equal payments on 1 April, 1 July, 1 October and 1 January in each year (hereinafter referred to as "the payment days")
>
> 3 [Apportionment of expenditure in first year of term]
>
> 4(1) As soon as practicable after the end of each year the Council shall ascertain the Service Charge payable for that year and shall notify the Lessee of the amount thereof
>
> 4(2) Such notice shall contain or be accompanied by a summary of the costs incurred by the Council of the kinds referred to in paragraph 7 of this Schedule and state the balance (if any) due under paragraph 5 of this Schedule.
>
> 5(1) If the Service Charge for the year (or in respect of the first year hereof the apportioned part thereof) exceeds the amount paid in advance under paragraph 2 or 3 of this Schedule the Lessee shall pay the balance thereof to the Council within one month of service of the said notice
>
> 5(2) If the amount so paid in advance by the Lessee exceeds the Service Charge for the year (or the apportioned part thereof for the first year hereof) the balance shall be credited against the next advance payment or

payments due from the Lessee (or if this lease has then been determined be repaid to the Lessee)

6(1) The Service Charge payable by the Lessee shall be a fair proportion of the costs and expenses set out in paragraph 7 of this Schedule incurred in the year

6(2) The Council may adopt any reasonable method of ascertaining the said proportion and may adopt different methods in relation to different items of costs and expenses

7 [A list of costs and expenses]

8 The summary of costs referred to in paragraph 4 of this Schedule shall contain an explanation of the manner in which the proportion of those costs apportioned to the flat under paragraph 6 of this Schedule have been calculated."

10. These provisions follow a conventional pattern of charging for services by reference to defined years, with equal quarterly payments based on an estimate of expenditure for the forthcoming year followed by a balancing payment or credit once a final year end account has been prepared.

The facts

11. The LVT did not examine the facts in detail in its decision, but from the documents which were before it, I take the following summary as the basis of my decision.

12. The service charges claimed by the appellant relate to the respondent's share of the cost of two programmes of major works carried out on the Estate. In 2003 the Estate was managed on behalf of the appellant by the Tabard Gardens Tenant Management Co-op ("the TMC"). The TMC wished to enter into a contract worth approximately £1.8 million for the replacement of windows in 19 blocks on the Estate, and on 30 October 2003 it wrote to the respondent and other leaseholders in the respondent's block, informing them of competitive tenders which had been received for that work. The letter broke three of the tenders down to show the price for the respondent's block and informed him that it was intended to accept the lowest tender and that the estimated contribution of each individual leaseholder would be 1/42 of the total cost. The respondent's share was estimated to be £3,486.27, although the letter emphasised that the final cost of the works might be higher or lower than that estimate.

13. The TMC subsequently placed the contract and carried out the work, completing it in June 2004. At about that time the TMC collapsed, leaving the respondent to resume direct management of the Estate. In the transfer of responsibilities back to the respondent, documents relating to the certification of the final contract price were either lost or never finalised. That created problems for the respondent when it wished to recover the cost of the works through the service charge, because it was not in a position to notify leaseholders of their share of the final costs of the works until after the expiry of

the 18-month period allowed by section 20B of the Landlord and Tenant Act 1985. In the event, although the appellant calculated that the final sum due ought to have been greater, it decided to restrict its claim to the estimated sum originally notified to leaseholders.

14. On 6 July 2005 the appellant delivered a document headed "Service Charge Invoice, Major Works" to the respondent, seeking payment of £3,486.27, referred to as "estimate charge: window renewal". On the reverse of the invoice, under the heading "Terms of Payment", it was said that payment could be made by equal instalments over 12-months "from the due date", although the invoice itself did not specify what that due date was. The invoice also stated that in the appellant's opinion the service charge demanded in the notice might entitle the leaseholder to a loan under certain housing regulations, and provided an address at which applications for such a loan could be made.

15. The respondent replied to the invoice expressing surprise at having received it from the appellant, rather than from the TMC, and asking questions about how the charge had been calculated and whether there had been adequate consultation. It is not necessary to track the subsequent protracted correspondence, in which the respondent refused to pay the charge for the replacement windows on the grounds that the TMC had not complied with the statutory consultation procedure under section 20 of the 1985 Act.

16. Separately from the major works involving the replacement of windows, in September 2004 the appellant began to consult leaseholders on a programme of works to refurbish or replace the cold water storage tanks on the Estate. Progress was slow and it was not until 22 September 2008 that leaseholders, including the respondent, were informed that their 1/42 share of the estimated cost of the works to their block was £517.68. That letter was accompanied by a reassuring leaflet stating that no money was to be collected yet, and that the appellant was aware that "some leaseholders are not in a position to settle their major works charges within a relatively short period of time as set down in the terms of their lease". The leaflet offered different payment schemes to help leaseholders, including payment by interest-free instalments over 36 months.

17. On 7 October 2009 the appellant wrote to the respondent enclosing an invoice for £518.49, representing the estimated charge for the replacement of the cold water storage tanks. The covering letter stated that under the terms of the respondent's lease he was liable to pay the invoice by four equal instalments over a period of 12 months, but drew attention once again to the willingness of the appellant to accept payment by standing order over 36 months.

18. At each stage of the consultation process the respondent objected in detail to the works proposed by the appellant and to their cost, and took issue with the form of the consultation notices. Once again it is not necessary to follow the course of that correspondence.

19. The replacement of the water tanks went ahead despite those objections and on 4 November 2010 the appellant informed the respondent that the final account had now been drawn up. The cost of works to the respondent's block was identified as £20,867.12, which was to be divided equally between the 42 units in the block. Once professional fees and an administration charge had been added, the respondent's contribution was stated to be £552.99. As this was greater by £34.50 than the estimated sum a further invoice for the balance of the respondent's contribution was provided. A statement was also delivered showing the total sum of £552.99 said to be due from the respondent for the cold water storage tanks, reflecting the fact that he had not paid the invoice delivered in October 2009.

20. The respondent refused to make any payment for either the windows or the cold water storage tanks and eventually the appellant commenced proceedings in the county court for the recovery of the aggregate sum of £4,039.26. That claim was transferred to the LVT on 7 July 2011 and was heard on 25 and 26 October 2011.

21. Finally, although the relevant documents were not put before the LVT, it was told that quite separately from the appellant's attempts to recover the cost of the major works it was estimating, billing and attempting to collect annual service charges for the other services it provided to the Estate. These routine services, referred to by the appellant as "revenue" service charges, were the subject of their own separate demands, generated their own separate disputes, and for the years 2005 to 2011 resulted in their own separate litigation between the parties.

The proceedings before the LVT and its decision

22. The proceedings before the LVT in this case related only to the service charges for the major works. In his statement of case the respondent challenged the appellant's entitlement to recover the cost of replacing the windows on four separate grounds. The first of those was that the claim was based solely on the estimated cost of the works and no final demand had ever been sent to him.

23. The respondent's case in relation to the cold water storage tanks focused on the adequacy of the statutory consultation and on the reasonableness of the work undertaken, which he alleged had been unnecessary and over-specified.

24. The appellant's evidence to the LVT asserted that its charging procedure was compliant with terms of the lease. Jennifer Dawn, an Accounts Manager in the Capital Works Group of the appellant's Home Ownership Unit, made a witness statement in which she said:

> "The Council charges major works in accordance with Part I of the Third Schedule. The Council's position is that charging major works charges pursuant to Part I of the Third Schedule of the Lease is the most reasonable and practical method of invoicing for a body of works. Estimate invoices are provided to

leaseholders and then at the completion of the major works contract (including the defects period) a final account is issued as soon as practicable."

25. In its decision the LVT considered first what it called "the landlord's charging practice". It recorded that the appellant expected payment for annually recurring service charges on the usual basis of an interim payment in advance with a balancing charge after the year end. It noted that although its standard lease entitled it to do so, in common with other local authorities, the appellant did not operate a reserve fund for major works because of the special provisions relating to the ring-fencing of local authority housing revenue accounts. Instead, local authorities give their tenants the right to pay for major works over an extended period. This practice, the LVT considered, was contrary to the terms of the lease because, as it explained (at paragraph 11 of its decision):

"Paragraph 4 of the Third Schedule requires the landlord to deal with service charges on a year-by-year basis. It is in our judgment simply not open to Southwark to issue separate demands: one for "ordinary" service charges on an annual basis and another for major works, which may well straddle two or more service charge years. The council in our judgment is obliged under paragraph 4 to issue one demand which wraps up both the ordinary service charges and that part of a major works contract which relates to that particular service charge year."

26. At the conclusion of the first day of the hearing, having explained the preliminary view it took on the inadequacy of the service charge demands, the LVT offered the appellant the opportunity, overnight, to rectify the defect by preparing new notices under paragraph 4 of the Third Schedule for each of the service years in question combining both the major works and the ordinary recurring service charges. In the event that task proved impossible to complete to the satisfaction of the LVT in the time available. The LVT noted that the respondent also wished to argue that no such revised notice could now be served, because of the requirement in paragraph 4(2) that notice be given "as soon as practicable after the end of each year".

27. The LVT therefore concluded that it was in no position to identify the amounts owing in each of the relevant service charge years. Nor could it give a decision on the annual amount which would be payable if proper consolidated annual charges were demanded. Not only had the necessary apportionment not been carried out, but there was no claim in the county court proceedings for a declaration of the amount due. The LVT reminded itself that, in a case which had been transferred to it by the county court, it was limited to the issues (and the relief) which arose on the pleadings in the county court. Nonetheless, it went on to give its views on the underlying merits of the respondent's other challenges to the service charges. It found those challenges to be of no substance and, but for its conclusion that the service charges had not been demanded in accordance with the terms of the lease, and but for the constraints of the relief sought in the county court, it would have made a determination that the full sum claimed by the appellant was payable by the respondent.

28. The appellant sought the permission of the LVT to appeal to the Tribunal. In its written application to the LVT the appellant suggested that not only was the decision wrong in requiring a single composite demand for both routine and major works charges, but also that it followed from the decision that the service of a revised demand after notice of the final sum due had been given was precluded, even where an item had been omitted from the calculation of the service charge by mistake.

29. The LVT granted permission to appeal, but made it clear that it did not agree that the effect of its decision was to preclude service of an amended demand. On the contrary, it considered that amended demands were permissible (hence it had invited the appellant to produce them in the course of the hearing). The sole ground on which permission was granted was the appellant's contention that the LVT had been wrong to interpret the Third Schedule as requiring that a demand be served consolidating both the ordinary service charges and the charges for major works in each year.

Submissions for the appellant

30. In its notice of appeal to the Tribunal the appellant contended that the LVT was wrong to hold that the lease required a single consolidated notice of service charges.

31. Mr Philip Rainey QC, who appeared on behalf of the appellant with Mr Michael Walsh, submitted:

(1) The lease should be interpreted in accordance with the normal principles of interpretation of commercial documents. The Tribunal should give effect to the purpose of the service charge provisions, and should avoid too literal a construction which might defeat it. That purpose was identified by the Court of Appeal in *Universities Superannuation Scheme Ltd v Marks & Spencer plc* [1999] L&TR 237 (which concerned charges payable under the lease of commercial premises in a shopping centre), in which Mummery LJ provided the following general guidance (at p.243):

> "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."

(2) The LVT had been correct to recognise that a revised final account could be served under paragraph 4 of the Third Schedule, which could incorporate the cost of major works omitted from an earlier demand based solely on "revenue" service charges. Mr Rainey referred to *Leonora Investment Co v Mott Macdonald* [2008] EWCA Civ 857 as a case in which the service of a revised service charge certificate had been contemplated as a means of correcting a previous omission. The appellant accepted that it had to comply with the terms of the lease, and was not suggesting, as Leonora had done, that it was entitled to operate the service charge on an ad hoc basis. The question was how it was to implement the provisions of the Third Schedule to recover the cost of major works when it had already given notice of the routine service charges. Could there be an *additional* notification, taking the form of a free-standing document confined to the major works and making no reference to the routine items?

(3) The LVT had been wrong to construe paragraph 4(1) as requiring a single notice, setting out the whole of the service charge liability for the preceding year. As a general matter of construction references in the Third Schedule to "notification" and to "notice" were capable of being read in the plural as well as the singular and should be construed as permitting more than one notice. There was little more than a semantic difference between serving a revised notice, which was permissible, and serving an additional notice, which the LVT had held was impermissible. The content of an additional notice need only add to the information already provided in a previous notice, and need not repeat it.

(4) The summary of costs and the statement of a balance required by paragraph 4(2) were both subsidiary matters, and a failure to provide such a summary or balance did not invalidate the notice. They were "directory" rather than "mandatory" components of the service charge machinery. Alternatively, neither the summary nor the balance need include all of the costs incurred in the year, and the omission of a particular cost or group of costs ought not to invalidate the notice. If the notice was an additional notice, it need only include in the summary the particular costs to which that additional notice related; the balance need only state the balance due in respect of the additional costs with which the notice was concerned.

(5) As far as the attribution of the costs of major works to particular service charge years was concerned, it ought not to matter in which year a charge was incurred. It was not permissible for the appellant to seek to recover charges before the end of the service charge year in which they had been incurred, but if it delayed the collection of the leaseholders' contributions to the cost of major works until the final account had been taken on the contract, that delay was for the benefit of leaseholders. It would be futile and artificial to insist that the total cost of the contract should be spread over each of the service charge years in which work had been carried out under the contract. If payments had been made by leaseholders on account, the final balancing payment should be treated as relating to a single service charge

year. Alternatively, it was open to the appellant to waive its entitlement to collect charges in the service charge year in which the work had been done, and to carry that outstanding cost forward to be collected in a future year when the final contract account was available at the conclusion of the major works. A notice under paragraph 4(1) could relate to costs incurred in more than one service charge year and ought to be valid even if it did not break down or apportion a charge for major works between different service charge years.

(6) On the assumption that the appellant was correct in its submission that an additional notice restricted to the major works was permissible, the invoice of 6 July 2005 for the costs of replacing the windows was an additional notice for the purpose of paragraph 4(1) and sufficiently satisfied the essential requirements described in paragraph 4(2). It identified the work in respect of which the charge was made and the balance of the service charge due for those works. Although it did not summarise the whole of the costs incurred by the appellant in replacing the windows in the block, nor indicate how those had been apportioned, those requirements should not be treated as mandatory, and an omission to comply with them should not invalidate the demand.

(7) On the same assumption, the invoice delivered on 7 October 2009 satisfied the requirements of paragraph 2(1) by providing an estimate of the respondent's contribution to the cost of replacing the cold water storage tanks. The material sent on 4 November 2010 was an additional notice under paragraph 4(1) and complied with all of the requirements of paragraphs 4 and 8.

(8) Mr Rainey supported his submissions by drawing attention to the practical difficulties which would be created if a strict adherence to the requirements of paragraphs 2 and 4 was insisted on. Service charges are payable for work done on each leaseholder's own block, and not on other blocks in the Estate; in contrast, the appellant's major works contracts were typically for whole estates, as in this case. With a major works contract for an estate of 19 blocks of flats it would not always be possible to know before the commencement of the service charge year whether work would commence during that year on any particular block, nor how much of the cost would be incurred in that year if work did begin. That would make providing a reliable estimate under paragraph 2(1) of the Third Schedule difficult. Similar practical difficulties would be created if at the end of each service charge year (rather than at the end of the contract as a whole) the appellant was required to ascertain how much had been spent on each individual block included in a major works contract. Stage payments made under a contract might relate to more than one block, and it would be cumbersome, time-consuming and expensive for the appellant to have to apportion payments annually and by block. It was more convenient, and therefore preferable, for the expenditure on work to each block to be ascertained at the end of the contract, without differentiating by reference to service charge years, and for

a single demand to be made covering the whole of that expenditure. If that meant a delay in the recovery of leaseholders' contributions, that was to their benefit.

(9) Mr Rainey also explained the appellant's preference for its approach to accounting for major works. Although its standard form of long lease includes, in Part II of the Third Schedule, provision for accumulating a Capital Expenditure Reserve Fund to spread the cost of major works over a long period, the operation of such a reserve fund is thought to be incompatible with the appellant's accounting obligations under the Local Government and Housing Act 1989. Section 74(1) of the 1989 Act imposes a duty on a local housing authority such as the appellant to have a Housing Revenue Account ("HRA"). The HRA is ring-fenced and section 76 of the Act imposes a duty to prevent a debit balance across the HRA as a whole in any year. If a local housing authority collects payments from its long leaseholders as contributions towards major capital projects to be undertaken in future, those payments would be required to be held in the HRA which would distort the authority's revenue accounting. Hence the appellant, in common with other local housing authorities, does not operate the reserve fund contemplated by its standard form of lease. Instead, its leaseholders are offered the opportunity to spread the cost of major works over a longer period than might strictly be permitted by the lease. In addition, funds are available to local authorities to provide service charge loans to leaseholders who have exercised the right to buy under the Housing Act 1985. Loans may only be made to enable such leaseholders to meet the cost of repairs to which they are liable to contribute through service charges; they are not available to meet the costs of other services. The appellant's method of billing for major works separately from routine service charges is therefore intended to distinguish clearly between charges for which loans or favourable payment terms may be available to leaseholders and others for which they are not.

Submissions for the Respondent

32. Ms Clare Parry, who appeared for the respondent, made the following submissions:

(1) Although the LVT's conclusion was correct in the result, it had been wrong to suggest that a revised service charge notice was permissible. The service of any notice purporting to be given under paragraph 4(1) exhausted the appellant's right to demand service charges in respect of the year to which the notice related. In any event, the LVT's observations about the service of a revised notice were made in response to the application for permission to appeal and did not form part of the decision under appeal. That issue should simply not be decided at this stage, but should be left for consideration by the county court where the validity of revised notices served by the appellant was being challenged by the respondent.

(2) The appellant had made no attempt to implement the neat and clear machinery of the Third Schedule as the parties to the lease had intended it to operate. Each of the requirements of paragraphs 4 and 8 was mandatory and if, contrary to her first submission, a revised notice was permissible, it had to be in proper form containing all of the information referred to.

(3) The respondent's payment obligation under clause 2(3)(a) of the lease was to pay the service charge "at the time and in the manner" set out in the Third Schedule. Compliance with the procedures by which the time and manner of payment were to be ascertained was therefore an essential precondition to the leaseholder's liability. That could be seen most clearly in paragraph 5(1) of the Third Schedule, by which the leaseholder's liability to pay did not arise until one month after the service of the notice under paragraph 4(2) stating the balance due. Until the necessary notice was served, the leaseholder was under no obligation to pay the service charge.

(4) On examination, the major works invoices relied on by the appellant did not begin to satisfy the requirements of paragraphs 2(1) and 4 of the Third Schedule. They did not purport to notify the respondent of the service charge payable for the year; instead they were limited to the major works alone and covered more than one year. They did not provide a summary of the costs incurred by the appellant, except in relation to the cold water storage tank works, and they did not state the balance due except in relation to the limited category of works to which they related.

(5) Finally, Ms Parry submitted that the way in which the LVT had dealt with the respondent's substantive challenges to the service charge was unsatisfactory. Although it had considered and expressed dismissive views on them all, it had done so after acknowledging that it could not give a final ruling on those issues. Its rejection of the respondent's challenges based on the adequacy of statutory consultation had not been part of the LVT's binding decision and the respondent had not therefore been in a position to appeal against it. Those parts of the decision should be disregarded and the same points should be remitted for further argument if the appeal was successful.

Relevant authorities

33. In every case the extent of a leaseholder's obligation to pay service charges will depend on the particular terms of the lease under which the obligation arises. In construing the lease which binds the parties in this case, only very limited assistance is likely to be found in the decisions of other courts concerning different leases. Nonetheless, in the course of argument both counsel referred to two decisions of the Court of Appeal which illustrate how similar issues of construction have been resolved in other cases.

34. *Universities Superannuation Scheme Ltd v Marks & Spencer plc* [1999] L&TR 237 concerned the liability of a tenant of a retail store in a shopping centre to pay a balancing charge at the end of the service charge year. The lease provided that the cost of providing services was to be certified by the landlord's managing agent and apportioned by reference to rateable values. The certificate was not expressed to be conclusive, and in the event the landlord's managing agent made a mistake in apportioning the service charges by applying the wrong rateable value to the premises. The tenant, in whose favour the mistake operated, nonetheless contended that the landlord was bound by the lower sum specified in the certificate, and that its liability to pay the service charge had been satisfied by paying that sum. The Court of Appeal rejected that contention and held that the landlord was entitled to serve a new certificate containing the correctly calculated charge because on the proper construction of the lease the tenant's obligation was to pay a sum calculated in accordance with the principles laid down in the relevant schedule. The managing agent's certificate was not made final and conclusive, either expressly or by implication, and if it the agent failed to adopt the correct principles of assessment a payment of the lesser sum which he had certified did not satisfy the lessee's obligation to pay the greater sum once it had been properly calculated.

35. In his judgment Mummery LJ made the general observations about the purpose of a service charge relied on by Mr Rainey which I have already quoted, and described the critical question as depending entirely on the construction of the relevant provisions of the lease. For that reason I do not think any further assistance can be provided by the Court of Appeal's decision.

36. The *Universities Superannuation Scheme* case concerned an inadvertent mistake in implementing the service charge procedures in a lease. A later decision of the Court of Appeal relied on by Ms Parry more closely resembles the present case in that it involved a conscious decision by a landlord to depart from the service charge procedure laid down by a lease.

37. In *Leonora Investment Co v Mott Macdonald* [2008] EWCA Civ 857 Mott Macdonald was the tenant of four floors in an office building under four separate leases on the same terms. The lease included a service charge entitling the landlord to recoup the cost of works and other services provided during the year. Each lease required the tenant to make quarterly payments on account, based on an estimate of anticipated expenditure provided by the landlord at the start of the year, followed by a balancing payment which became due on demand once the landlord provided a statement of the actual service costs for the year. During the year in question the landlord carried out works to the common parts of the building which had not been referred to in the estimate on which the tenant's quarterly payments had been based and to which no contribution had therefore been made. The works were completed before the service charge year ended on 24 December 2002. On 15 January 2003 the landlord's agent sent a single invoice to the lessee demanding payment of the tenant's share of the cost of the works, without differentiating between the four leases under which the tenant occupied its premises and without providing the statement of actual service costs for the whole year which those leases contemplated. Two days after the delivery of the invoice the landlord completed a sale of its interest in the building.

38. The landlord argued, ambitiously, that because it had not included the major works in the estimate of service costs and so had not collected advance payments for them, it was not limited to recouping the cost of the works through the balancing charge but was free to raise an invoice for the whole of the costs as a stand alone charge. The provision of a statement of the full service expenditure for the year was an entitlement of the tenant but it was not a condition precedent to the obligation to pay.

39. The Court of Appeal rejected the landlord's argument and found that the tenant was not liable to pay for the major works until the landlord followed the contractual route which would entitle it to recover the balance of the full year's service costs. That route required the provision of a statement of service costs which would trigger the obligation to pay. At paragraph 24 of his judgment Tuckey LJ made the following general observation:

> "The conclusion I have reached may seem harsh or over technical, but if so it results from what I consider to be the proper construction of the leases. 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."

Discussion

40. Where a contract lays down a process giving one party the right to trigger a liability of the other party, such as the payment of a sum of money in response to a demand, it is a question of construction of the contract whether the steps in the process are essential to the creation of the liability, or whether the process may unilaterally be varied or departed from without invalidating the demand. Where issues such as those in this appeal arise, it is necessary to identify the minimum requirements laid down by the lease before the obligation to pay the service charge will be created, and then to consider whether the circumstances of the case satisfy those minimum requirements. In considering each of those matters it is not appropriate to adopt a technical or legalistic approach. The service charge provisions of leases are practical arrangements which should be interpreted and applied in a businesslike way. On the other hand, precisely because the payment of service charges is a matter of routine, a businesslike approach to construction is unlikely to permit very much deviation from the relatively simple and readily understandable structure of annual accounting, regular payments on account and final balancing calculations with which residential leaseholders are very familiar. When entering into long residential leases the parties must be taken to intend that the service charge will be operated in accordance with the terms they have agreed. Leaseholders should be able to work out for themselves whether a sum is due to be paid by reading the lease and comparing the process it describes with the information provided in support of the demand by the landlord, without the involvement of lawyers or other advisers.

41. The narrow questions in this appeal are whether the invoices delivered by the appellant on 6 July 2005, 7 October 2009 and 4 November 2010 were sufficiently in

conformity with the Third Schedule to create a liability on the part of the respondent to pay. The starting point in considering those questions is to focus on the service charge obligation of the leaseholder and in particular on how and when his obligation to pay arises. The covenant at clause 2(3)(a) requiring payment of the Service Charge "at the time and in the manner" set out in the Third Schedule is the source of that obligation.

42. The expression "Service Charge" is defined in paragraph 6(1) of the Third Schedule, which provides that "the Service Charge payable by the Lessee shall be a fair proportion of the costs and expenses … incurred in the year". That definition clearly connects the sum payable by the leaseholder to the appellant's expenditure in a particular service charge year.

The advance payments under paragraph 2

43. The initial payments for any year are those required by paragraph 2 of the Third Schedule. The time and manner of those payments is quarterly on the defined payment days in response to a notification by the appellant of its reasonable estimate of the amount which will be payable by the lessee by way of Service Charge in the forthcoming year.

44. Although paragraph 2(1) requires the appellant to notify the leaseholder of its estimate before the commencement of the year, some flexibility is introduced by the direction in paragraph 1(2) that time is not to be of the essence for service of any notice under the Third Schedule. Thus, if the appellant failed to give notice of its estimate for the year until after the service charge year had commenced, it would not be prevented from doing so at a later date.

45. The same flexibility would have been available even without the parties' express agreement that time was not to be of the essence for the service of notices. The general rule in property contracts is that stipulations relating to time are not regarded as essential unless the contract provides so either expressly or by necessary implication (as in the case of options or break clauses). That was the approach taken by equity and given statutory effect and general application by what is now section 41 of the Law of Property Act 1925.

46. Nonetheless, in this case the parties have avoided any doubt or misconception over the significance of the time by which notices are to be given by their express agreement that time is not to be regarded as essential. That is not to say that the appellant is free from an obligation to comply with the agreement in paragraph 2(1) that it will give notice of its reasonable estimate of the amount payable by the leaseholder by way of service charge before the commencement of each year. The appellant is required by the contract to perform that obligation, but if it fails to do so in time the consequence is not that it is then prevented from giving notice of its estimate. The appellant would remain under an obligation to notify the leaseholder of its reasonable estimate of the Service Charge and, once notified of the estimate, the leaseholder would come under an obligation to pay that sum in advance on account of the Service Charge as required by

paragraph 2(2). If the appellant failed to provide the estimate before the commencement of the service charge year on 1 April the leaseholders would be under no obligation to make a payment in advance *on that date*, and would in any event be unable to do so because they would not know how much to pay. There are a number of ways in which the leaseholder's obligation in the event of a late notification might be analysed, but since these were not addressed in argument I express no view on them.

47. Paragraph 2(1) requires the appellant to make "a reasonable estimate of the amount which will be payable by the Lessee by way of Service Charge (as hereinafter defined) in that year". This case raises the question whether the appellant is entitled to omit from its estimate some component of the expenditure which it can reasonably anticipate will be incurred. That is what it did in relation to the leaseholder's share of the window replacement contract which was not included in the service charge estimate for 2004-05 or 2005-06.

48. It is the appellant's case that it is not required to include the cost of major works in the estimate it provides under paragraph 2(1), and Mr Rainey QC submitted that there were practical reasons why it was inconvenient for it to do so. I quite accept that there will be occasions when there is uncertainty over whether work will be undertaken in one service charge year or in the next, but paragraph 2(1) does not require certainty, only a reasonable estimate. In this case a statutory consultation notice was given on 30 October 2003 estimating the leaseholder's contribution towards the cost of replacing the windows. The contract was entered into on 11 December 2003 with a contract period of 24 weeks, and practical completion was signed off on 21 June 2004. The appellant must have known before 1 April 2004 that at least part of the cost of the replacement windows would be costs and expenses it would have to meet during the forthcoming service charge year. Even if the appellant preferred to wait until the defects liability period had expired and the final payments under the contract had been made before seeking to recover the costs of the replacement windows through the service charge, it would certainly have been in a position to provide an estimate of the costs which it intended to pass on to each leaseholder in the forthcoming year in time to include them in the estimate for 2005-06 which was due to be served before 1 April 2005. In the event no part of the cost of the windows was included in any estimate under paragraph 2(1) and the leaseholders were instead sent invoices for the full amount of their share, which included expenditure incurred in at least two service charge years, on 6 July 2005.

49. Mr Rainey QC submitted that the right to require payment in advance towards the cost of services was a provision of the contract included entirely for the benefit of the appellant, to provide a regular cash flow and to enable it to collect funds to cover its costs and expenses before they were incurred. Paragraph 2(1) was ancillary to that entitlement, but if the appellant preferred not to include a particular item of its anticipated expenditure in the estimate it was free to omit it.

50. If Mr Rainey is correct in characterising paragraph 2 as being solely for the benefit of the appellant then, on normal contractual principles, the appellant would be entitled to waive its right to include any individual component of expenditure in the advance payment and in the estimate, and could even forego advance payments and dispense with

the estimate altogether. However, in my judgment the appellant does not have the suggested freedom to waive the requirements of paragraph 2(1). While I accept that the obligation on the leaseholder in paragraph 2(2) to make advance payments on account of the Service Charge is rightly regarded as being for the sole benefit of the appellant, and therefore is capable of being waived in whole or in part, I do not think the same can be said of the obligation to provide a reasonable estimate of the amount payable by the leaseholder by way of Service Charge in the forthcoming year. One important function of the estimate is to provide the leaseholder with advance warning of the contribution which he will be expected to pay for the services to be provided in the forthcoming year. The estimate has obvious benefits for the leaseholder in setting his own personal budget for the year, and in avoiding an unexpected demand at the end of the year for which no provision may have been made. On the same normal contractual principles it is not open to one contracting party unilaterally to waive terms of the contract which confer benefits on another party.

51. I therefore conclude that paragraph 2(1) imposes a positive obligation on the appellant, which it is not entitled to waive, to provide a reasonable estimate before the start of the year of the Service Charge which will be payable by the leaseholder in that year. Interpolating the definition of Service Charge from paragraph 6(1), the appellant's obligation is to provide a reasonable estimate of the fair proportion of the costs and expenses to be incurred in the year which will be payable by the leaseholder. If the appellant reasonably anticipates that its expenditure will include expenditure on major works, as it could have done in this case, it is required to include that expenditure in its estimate. The omission of such expenditure from the estimate is not consistent with the contract.

52. Given that the appellant did omit the major works expenditure from its annual service charge estimates, what is the consequence of that omission? In principle at least a leaseholder could enforce the appellant's obligation to provide a comprehensive estimate by a claim for damages (which would be unlikely to be more than nominal) or by an application for an injunction or specific performance. In *Morshead Mansions Ltd v Mactra Properties Ltd* [2013] EWHC 224 an order was granted in the High Court for the provision by a landlord of proper service charge accounts for a residential block. In *Wembley National Stadium Ltd v Wembley (London) Ltd* [2007] EWHC 756 at [67] a similar remedy was contemplated in a case involving a final account of service charges payable under the lease of Wembley Stadium. Circumstances in which a leaseholder might wish to enforce the obligation in paragraph 2(1) to provide an estimate are unlikely to occur frequently, but might if a leaseholder intended to sell and wished to provide prospective purchasers with a clear idea of the likely service charge liability. In normal circumstances, however, the only practical consequence of a failure to take account of major works in the estimate would be that the appellant would not be entitled to collect advance payments from the leaseholders which included any contribution towards the cost of those works. There can be no suggestion that the appellant is prevented from recovering the cost of the major works altogether, and Ms Parry did not suggest that the omission of the major works from the estimate under paragraph 2(1) would provide a defence if the cost of the works was later included in a proper notice under paragraph 4(1). The cost of the major works remains part of the Service Charge for the year or years in which it was incurred, whether or not it was included in the original estimate.

Notification under paragraph 4

53. Paragraph 4(1) of the Third Schedule requires the appellant as soon as practicable after the end of each year to ascertain the Service Charge payable for that year and to notify the lessee of the amount. Once again, and for similar reasons to those given above, paragraph 4(1) creates an obligation on the appellant which it is not at liberty to waive and which would be capable of enforcement by a leaseholder.

54. I agree with Ms Parry's submission that by virtue of paragraph 5(1) a contractually compliant notification under paragraph 4(1) is the essential precondition of the leaseholder's liability to pay the balance of the Service Charge in the event that the charge for the year exceeds the amount paid in advance under paragraph 2. The obligation to pay is triggered by service of the notice and must be satisfied within one month. If the payments made in advance exceed the Service Charge for the year, paragraph 5(2) entitles the leaseholder to a credit to be set against his liability to make an advance payment for the next year. For that reason the notification under paragraph 4(1) is not something which the appellant can dispense with or delay since the leaseholder is entitled to know as soon as practicable after the end of the year if he is entitled to a credit. In circumstances where one head of expenditure, such as the cost of major works, has been omitted entirely from the assessment of the sum payable in advance, a compliant notification under paragraph 4(1) is the only contractual route by which the appellant can recover contributions to that expenditure from its leaseholders.

55. Paragraphs 4(1), 4(2) and 8 lay down the minimum requirements of a valid notification. It must have four features:

(1) It must notify the leaseholder of the amount of the Service Charge payable for the relevant year.

(2) It must contain or be accompanied by a summary of the costs incurred by the appellant of the kinds referred to in paragraph 7.

(3) It must state the balance (if any) due under paragraph 5.

(4) The summary of costs which it contains must include an explanation of the manner in which the proportion of those costs apportioned to the flat under paragraph 6 has been calculated.

56. In my judgment, each of these features is essential to the validity of a notification under paragraph 4(1). The notification not only creates the liability to pay but performs an important function in enabling the leaseholder to understand the extent of that liability and to consider whether it has been correctly calculated. The leaseholder is neither expected to take the appellant's assertion of the sum due on trust, nor to carry out his own calculation to work out his liability. He is entitled to be provided with details of the

appellant's expenditure and an explanation of the sum which it calculates to be due for the year.

57. Each of the features required by paragraphs 4(1), 4(2) and 8 provides indispensable information to enable the leaseholder to verify the appellant's assessment. The summary of costs is necessary to enable the leaseholder to compare the heads of expenditure incurred by the appellant with the costs and expenses listed in paragraph 7 which the leaseholder is bound to contribute towards. The explanation of the manner in which those costs have been apportioned, required by paragraph 8, is necessary to enable the leaseholder to understand the appellant's calculation. Paragraph 6(2) entitles the appellant to adopt different methods of apportionment in relation to different items of costs and expenses, and I was informed that in practice the cost of major works is apportioned by different criteria from the cost of revenue items; the details of the apportionment are therefore essential elements of the calculation of the leaseholder's liability. The amount of the Service Charge for the year is the product of that apportionment, and an important statement of the leaseholder's total liability from which he will be able to determine for himself whether he is entitled to a credit or liable to make a balancing payment. The statement of the balance (if any) due will inform the leaseholder of the amount which the appellant expects to receive. If that balance has been correctly calculated, the leaseholder will know what his liability is. It may well be that in most cases a leaseholder would be able to work out the balance of the Service Charge due from other sources of information, but that need not always be the case (where the lease has been assigned, for example, advance payments may have been made by the leaseholder's predecessor).

58. I therefore do not accept Mr Rainey's submission that certain elements of the description of a notice should be regarded as subsidiary, inessential or merely directory. The service charge machinery is not complex or technical; it is clear and straightforward, and the parties are not likely to have intended that it would be deviated from by omission of any of the simple steps by which the sum due is quantified and explained. Without each of the pieces of information to be notified to the leaseholder a purported notice would therefore fall short of the requirements of paragraph 4(1) and would create no liability on the part of the leaseholder.

59. Subject to those essential features, however, I agree with Mr Rainey that the requirements of notice under paragraph 4(1) should be approached in a non-technical manner. In particular, I agree that it is not necessary that all of the information be provided in a single document or even on a single occasion. If on an objective reading of two or more documents on which reliance is placed it would be clear to a reasonable recipient, familiar with the terms of the lease, that the appellant was providing notice for the purpose of paragraph 4(1), and provided that taken together the documents satisfied the minimum requirements I have referred to above, I can see no reason why a single document should be insisted on. There is no reason why service charges for major works should not be identified in a separate document if that is thought to be more convenient for the purpose of identifying charges for which loans or different payment terms are available, provided that the leaseholder is also provided with a statement of the total Service Charge and the balance due for the year. If after notice has been given of the Service Charge for the previous year an additional item of expenditure, previously

overlooked, is discovered it would be sufficient for the appellant to provide a statement of the nature and amount of that additional expenditure without repeating its previous summary of the whole of the costs and expenses incurred in the year. It would be essential, however, for the relevant notification to state the total Service Charge for the year, recalculated to take the additional item into account, to identify the method of apportionment which had been adopted and to state the new balance due. An additional notification which left leaseholders to work out for themselves that there was no overlap between the cost of major works and the sums previously demanded for revenue items, and to calculate the aggregate Service Charge for the year and the balance now due from them, would in my judgment be defective.

60. I also consider that annual accounting is essential to the validity of a notification under paragraph 4(1). Annual accounting promotes clarity and ease of comparison for leaseholders. Avoidable complexity, inconsistency and obscurity in accounting are obvious causes of confusion and dispute in relation to service charges and the parties cannot be taken to have intended that costs and expenses incurred in more than one year should be dealt with collectively outside the framework of annual accounting clearly contemplated by the Third Schedule.

61. As with a failure to comply with contractual stipulations as to time, a departure from the minimum requirements for effective notification is not irremediable. Adherence to those requirements and to the annual framework does not require that costs which the appellant fails to account for in the year in which they are incurred should become irrecoverable. In the absence of agreement or acquiescence by leaseholders it does, however, require that when the appellant wishes to collect the contributions to which it is entitled it should provide a revised or additional notification which, either alone or in conjunction with material previously supplied, is compliant with paragraph 4(1) and allocates costs to the years in which they were incurred. As with the provisions considered by the Court of Appeal in *Leonora*, there is no scope for saying that the provisions of the appellant's standard lease only give it one opportunity to get its demands right.

62. Although the LVT considered that it is "simply not open to Southwark to issue separate demands", the appellant is obviously free to make alternative arrangements by agreement with its leaseholders. Such arrangements, especially in relation to major works, may be less administratively burdensome for the appellant. Many leaseholders may be unconcerned about strict compliance with the terms of the lease and content with a more ad hoc approach, especially one which delays the date of payment and allows the cost of work to be spread over a longer period than the single year provided for by the lease. Any leaseholders who availed themselves of the favourable payment terms offered by the appellant would no doubt be taken to have agreed to waive strict compliance with the Third Schedule, so far as it related to the cost of major works. Despite those attractions for both parties, where the appellant adopts such an ad hoc approach without prior agreement it runs the risk, illustrated by this case, that an individual leaseholder may use the failure to conform with the minimum contractual requirements as a defence to liability. In the event of disagreement the appellant might consider it prudent to revisit the documents it relies on and to supplement or reissue them as necessary to bring them into conformity with the Third Schedule.

The invoices

63. It will be clear from this discussion that I do not accept Mr Rainey's submission that the invoices for the major works were compliant with the requirements of the Third Schedule.

64. The invoice for the replacement windows provided on 6 July 2005 was limited to those works and did not include a statement of the total Service Charge for any year or the balance due from the leaseholder. Nor did it provide an explanation of the method of apportionment which had been adopted. Finally, the costs which it included had been incurred in several years, which were not identified. In each of these respects the invoice failed to comply with the requirements of paragraph 4(1).

65. The invoice for the estimated cost of replacing the cold water storage tanks delivered on 7 October 2009 did not purport to be an estimate of the total Service Charge for the forthcoming year and was not in accordance with paragraph 2(1). The covering letter which accompanied it stated incorrectly that the terms of the lease required the leaseholder to pay the invoice by four equal instalments on the payment days. In reality, having omitted the major works from the estimate previously provided under paragraph 2(1) the appellant was not entitled to any advance payment towards the cost of those works and was required to wait until after the year end to include the cost in the final Service Charge account.

66. The final account documents for the tanks, which were delivered on 4 November 2010, came closest to satisfying the requirements of paragraph 4(2). They summarised the costs incurred on the work done to the respondent's block, explained how that total was apportioned between the 42 flats in the building, notified the leaseholder of his total contribution, and provided a statement of the balance due. However, the documents were confined to the major works alone, and did not make reference to any similar details which may have been provided for revenue expenditure, nor provide a consolidated statement of the total service charge and the total balance due from the leaseholder. For the reasons I have given I therefore consider that the documents were not in compliance with paragraph 4(1) and did not create a liability on the part of the leaseholder to pay the sum demanded.

Conclusion

67. For these reasons the appeal is dismissed.

68. I would add this in response to Ms Parry's submission recorded at paragraph 33(5) above. In principle there is nothing objectionable in an LVT making a determination on all of the points argued before it, even if it concludes that there is a fatal flaw in the procedure adopted by a landlord which means that no service charge is due and the leaseholder's subsidiary grounds of challenge to those charges do not arise. In the event of a successful appeal against the LVT's primary conclusion, a clear alternative

determination may make it unnecessary to remit the case to the LVT for further consideration. In this case it was argued by Ms Parry that the LVT had not made a final ruling on the substantive dispute on the major works and had confined itself to "expressing a view". There has been no cross-appeal on the LVT's treatment of the underlying merits issues. Since the continuing county court proceedings between the parties have now been amended to included revised service charge demands, and since the scope and effect of the LVT's decision may be a live issue in those proceedings, it is better that I express no view on that issue.

Dated: 18 July 2013

Martin Rodger QC, Deputy President