

WHEN SERVICE CHARGES ATTACK

LESSONS FROM

THE WORLD OF POPULAR MUSIC¹

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1. Service charge provisions can cause a great deal of trouble for landlords, agents and tenants alike. Provisions can be misconstrued. Badly drafted provisions can be hard to apply. A situation might arise ten years into a lease which the parties did not anticipate at the outset. This paper is intended to suggest some coping strategies for those of us who must, from time to time, untangle service charge disputes.

2. I am concerned here with commercial service charges, and do not consider the residential statutory overlay. For those who are so tantalised by what they read that they must find out more, may I, dispassionately, recommend the excellent Rosenthal, Fitzgerald, Duckworth, Radley-Gardner and Sissons' Commercial and Residential Service Charges, available from all good booksellers (Bloomsbury Professional).

"You Can't Always Get What You Want"

3. Mick Jagger reminds us that leases are contracts which set down the rules controlling what the parties can and cannot do. If a contract prescribes machinery that must be operated in order for an outcome under the contract to be brought about, that machinery is to be operated.² That may seem quite an obvious statement, but it is not often done. Managing

¹ The reader should not necessarily derive from the song selection any conclusion about the contents of the author's iTunes library. Songs have been selected purely on the basis that they shed light on service charge issues which are commonly encountered in practice.

² St Mary's Mansions Limited v Limegate Investment Co Limited [2003] 1 E.G.L.R. 41, at paragraphs [32] – [39]; Mohammadi v Anston Investments [2004] L&TR 6; FCH Housing and Care v Burns [2007] EWLands LRX 9_2006 at paragraph [16]; Redendale Limited v Modi [2010] U.K.U.T. 346 (LC); London Borough Of Southwark v Woelke [2013] UKUT 349 (LC)

agents frequently use accounting software that is not designed with the lease in mind, and many property professionals do not, before works are commissioned, undertake a detailed construction of the lease terms to find out who is responsible for the windows, or whether the outside walls are inside or outside the demise, or if the shopping centre tenants can be made liable the cost of Santa visiting the food court on a promotional trip at Christmas.

“Don’t Give Up”

4. Peter Gabriel (feat. Kate Bush)’s advice was spot on here.

5. In Leonora Investment v Mott McDonald [2008] EWCA Civ 857, the landlord was entitled to recover for specified service charge items, by providing an estimate of cost in advance of the service charge year, with an on-account payment due quarterly. At the end of the year, a balancing payment was then due. However, the landlord forgot to claim for particular works items. Rather than re-serve any estimate and demand, or seek recovery under the year-end balancing payment, and entirely separate invoice was given, which the landlord said was outside the lease, but which the landlord claimed it was entitled to do as the lease was to be treated as non-exhaustive.

6. Tuckey L.J. stated (at paragraph [22]) that: “I do not see this as a case in which the leases contain a condition precedent to the landlord’s right to recover. Rather they prescribe the contractual route down which the landlord must travel to be entitled to payment. The prescribed route in this case is, we are told, a very familiar one and it is obviously not difficult to follow. The statement will be of considerable importance to the tenant. It gives him information about the actual service costs for the past year, which only the landlord will know, and how they have been apportioned to him so that he can make an informed decision as to whether to pay or not in the knowledge that the landlord may acquire a right to forfeit if he does not. [Counsel for the landlord] had to accept in argument that the logic of his submission was that the landlord can make a demand for service charge outside the part 2 regime in any form, for any service cost for up to six years. This would be contrary to what

sensible commercial parties would contemplate in a relationship carefully defined by the terms of a commercial lease.”

7. Tuckey LJ stated further (at paragraph [24]) that: “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.”

8. The lesson to be learned here is that, when a landlord or agent is concerned that some part of the machinery may not have been operated properly, the answer may well be: “give it another go”. Unless (which would be unusual) time is of the essence for the giving of year end accounts or a demand, there will usually be a further opportunity for the landlord to get it right, and have another go.

9. The issue is an important one, however. This is because leases are often drafted with a condition precedent structure. An expert may need to apportion service charge, or a surveyor may need to assess what is reasonable, or accounts might have to be produced, or a written demand may need to be made. If an action is brought for sums allegedly due from the tenant without those contractual hoops being jumped through, then one might find that the tenant has a convincing defence.³ The Courts and Tribunals have regularly found that such steps are conditions precedent without which no monies are due from the tenant, though there are rare exceptions which it is useful to be aware of.⁴

³ Jacey Property Company Limited v De Sousa [2003] E.W.C.A. Civ 510; Barrington v Sloane Properties Limited [2007] EWLand LRX/312006; Brent London Borough Council v Shulem B Association Limited [2011] 1 W.L.R. 3014. On experts and conditions precedent, see http://www.falcon-chambers.com/uploads/docs/section9/PBA_EXPERTS_TALK.pdf

⁴ Clacy v Sanchez [2015] UKUT 387 (LC) would be a rare example of a certification process not being a condition on the terms of the lease in that case; it was decided that the certificates were optional and confirmatory only on the terms of that particular lease. Another example would be Scottish Mutual Insurance Plc v Jardine Public Relations Ltd [1999] EWHC 276 (TCC)

“Don’t Stop Til You Get Enough”

10. Michael Jackson reminds us that the essential commercial function of a service charge provision is for the landlord to recoup expenditure which has been laid out in conformity the provisions of the relevant lease. That is not to say that the Court will construe a lease which on its face gives a landlord something less than full recovery so that it does;⁵ but it does mean, apparently, that the Courts will not look favourably on arguments that the mechanism has been operated badly by the landlord and he therefore has to bear the shortfall.

11. Universities Superannuation Scheme Ltd v Marks and Spencer Plc [1999] 1 E.G.L.R. 13 is a good illustration of this. The case concerned year end balancing payments in relation to a lease of a retail unit. The tenant’s liability was to be calculated proportionately to the rateable value of the unit. The tenant was to be given a (non-conclusive) certificate setting out the landlord’s global spend on the entire leasehold scheme (rather than a break down per unit), such certificate to be issued “as soon as practicable”. The trouble was that the landlord’s managing agent had over-complied. It had calculated the tenant’s actual share, and it had done so incorrectly. It was too low. The tenant argued that it had paid what had been claimed, and that the landlord was not entitled to any more. That argument found favour at first instance before Blackburn J. The Court of Appeal, however, allowed the landlord’s appeal. It held that The starting point is that the commercial point of a service charge mechanism is to allow the landlord to recover the amounts it has reasonable incurred in a particular service charge year. The tenant had covenanted to pay a service charge by reference to the true rateable value of the premises. Payment of a lesser amount was not a discharge of that obligation. All the certificates were required to show was the total amount of expenditure in any year. They were not, on the facts, intended to be conclusive and determinative for all purposes.

“It’s Only Words”

12. This dictum by the Bee Gees needs to be revisited in light of recent Court of Appeal authority.

⁵ Rapid Results College v Angell [1986] 1 E.G.L.R. 53

13. To move from the Gibb brothers to Albert Einstein,

“Compound interest is the eighth wonder of the world. He who understands it, earns it ... he who doesn't ... pays it.”

14. This painful lesson was learned by the residents of a Welsh holiday park. They had agreed to pay service charge as follows:

“To pay to the Lessor without any deductions in addition to the said rent as a proportionate part of the expenses and outgoings incurred by the Lessor in the repair maintenance renewal and renewal of the facilities of the Estate and the provision of services hereinafter set out the yearly sum of Ninety Pounds and Value Added tax (if any) for the first Year of the term hereby granted increasing thereafter by Ten Pounds per hundred for every subsequent year or part thereof.”

15. What's another tenner between friends? Well, quite a lot when you compound it. You may be familiar with the illustration of the grain of rice on a chessboard. If a single grain is put on the first square, and then the number of grains is doubled with every square, but the time you get to square 40 (with 24 more to go) that square will contain 549,755,813,888 grains of rice.⁶

16. This was the issue faced by the Supreme Court in Arnold v Brittan [2015] UKSC 36. Should the Court interpret a contract using “commercial common sense” to avoid a consequence which might strike one as unfair in outcome, or should the Court hold the parties to a bargain which has turned out to be unwise?⁷ The Supreme Court emphasised the primacy of the language used by the parties. Whilst acknowledging that “commercial common sense” had a role to play, such common sense did not trump what the parties had in fact said, especially when the nonsense only manifested itself retrospectively. For instance in Arnold, what looks to our modern eyes to be a swingeing bargain was actually concluded at a time of rampant inflation, when less of an eyebrow would have been raised. The Supreme Court reminds us that freedom of contract includes the freedom to strike a bad bargain.

⁶ Another way of testing it is to keep folding an A4 sheet of paper in half.

⁷ For detailed consideration, see Elizabeth Fitzgerald's article which can be found at this link:
http://www.pla.org.uk/images/uploads/library_documents/Hard_Cases_Sometimes_Make_Good_Law.pdf

17. This return to the words used also underpins the other recent Supreme Court of note, on implied terms and prospective rent apportionment, Marks and Spencer Plc (M&S) v BNP Paribas Securities Services Trust Company (Jersey) Limited (BNP) [2015] UKSC 72. In that case, the question was whether a tenant, in order to exercise a break option, had to pay a full quarter's rent even though it would not have a full quarter's possession up to the break date, or whether the tenant could reclaim that rent attributable to the period following the break under an implied term. The Supreme Court declined to imply a term; it was essential for implication of a term that it was necessary to give business efficacy to the contract, and if the contract lacked coherence without it. An agreement to pay a full quarter's rent even though there would not be a full quarter's enjoyment *might* be a bad bargain; but such an express term did not render the contract incoherent.

18. Those two cases might be said to be a re-affirmation of the primacy of the words used. It is not enough, it seems, to simply argue that the consequences of a particular construction are unattractive.

Conclusions

19. What, then, is the right approach to service charge provisions? Arnold tells us very clearly that there are no "special rules" of construction that apply to them. They are just a part of an ordinary contract, albeit a contract in writing which usually descends to a great deal of detail. The guiding motto is: do what the lease says, and, if you don't, it is usually possible to have another go. Obviously, in an emergency, break glass and shout estoppel. But you may find that the problem is fixable before you have to resort to that.