Service charges: recovering overpayments from the landlord

WHAT HAPPENS IF A TENANT PAYS MORE by way of service charge to its landlord than it was contractually obliged to pay? Common sense would seem to dictate that the tenant is entitled to be reimbursed the overpayment. However, as this article explains, the answer is not always that straightforward.

INTRODUCTION

Almost every well-drafted lease, whether of commercial or residential premises, will contain an obligation on the part of the tenant to contribute towards the landlord's costs of maintaining, insuring and managing the building of which the demised premises form part. However, as one would expect where the party providing the services is not the same as the party who ultimately foots the bill, disputes about how much the tenant is liable to pay are commonplace.

These disputes often arise at the stage when the landlord makes a demand for payment. If so, the dispute will usually be resolved, either by agreement or litigation, before the tenant makes the relevant payment. However, at other times, the tenant will have already made the payment by the time it realises that the landlord had not been entitled to the full amount. In such cases, the tenant may be content to simply set off the overpayment against its service charge liability for the following year.[1] But if the lease contains an anti-set-off provision[2] or if the tenant has cash-flow difficulties, the tenant will instead wish to be reimbursed. The means by which the tenant may seek to achieve that result are examined below.

RESTITUTION

In *Kleinwort Benson Ltd v Lincoln CC* [1999], the House of Lords made clear that payments made under a mistake of law may be recovered by way of a claim for unjust enrichment in just the same way as payments made under a mistake of fact. What needs to be established is:

1) that the paying party was mistaken in some respect at the time the payment was made;

2) that the mistake caused the payment; and

3) that the payment was not due to the payee.

Before applying these principles to the present context, it is necessary to consider the circumstances in which an overpayment of service charge may be made:

1) An overpayment may occur as a result of an administrative error on the part of the tenant or its agent (eg misreading the figure on the landlord's letter of demand or putting the decimal point in the wrong place on an electronic transfer).

2) Where the tenant pays interim service charge (ie a sum based on the landlord's estimated costs for the year) that is later found to be greater than the tenant's final service charge liability (ie a sum based on the landlord's actual costs for the year), the tenant will, in effect, have overpaid.

3) Overpayments also occur where the landlord demands and the tenant then pays service charge which is not due under the terms of the lease (eg where the costs claimed by the landlord fall foul of an express or implied term of reasonableness in the lease) or is barred by statute (eg under the Limitation Act 1980 or, in the case of residential leases, under the provisions of the Landlord and Tenant Act 1985).

Applying the test set out in *Kleinwort Benson Ltd v Lincoln CC* to the above categories of overpayment, the position is as follows:

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1) Overpayments made as a result of an administrative error clearly satisfy the test and are *prima facie* recoverable by means of a claim for unjust enrichment.

2) By contrast, overpayments of interim service charge do not satisfy the test because the tenant was not operating under any kind of mistake at the time the payments were made. However, although overpayments of interim service charge will not be recoverable by means of a claim for unjust enrichment, it is usual for leases to make express provision for the treatment of any service charge excess at the end of the year (see below) and, in such cases, the tenant will instead have a contractual remedy.

3) Comparatively subtle questions arise where the overpayment is made in consequence of the landlord having demanded too much service charge from the tenant. If the tenant was wholly ignorant of the fact that it was not liable to pay some or all of the service charge demanded by its landlord, then the overpayment should be recoverable by means of a claim for unjust enrichment. At the other end of the scale, a tenant that is fully aware that the landlord is demanding too much, but pays anyway (eg because it wishes to preserve its relationship with the landlord or to avoid having to defend forfeiture proceedings), was not mistaken at the time of payment and will correspondingly not be able to recover its overpayment at a later date. But what happens where the tenant merely harbours suspicions that its landlord is demanding too much at the time the payment is made? Such cases will raise difficult questions of both fact and law as to whether the tenant was 'mistaken' and, if so, whether that mistake could be said to have caused the payment to be made. If, however, the tenant can show that it believed that it was more likely than not that the tenant was liable to make the payment at the time that payment was made, it is likely that the tenant will be entitled to recover the overpayment.[3]

However, even if an overpayment is *prima facie* recoverable by means of a claim for unjust enrichment, that is not the end of the matter. There are a number of potential defences to an unjust enrichment claim which may, in an appropriate case, enable the landlord to retain its windfall.

Innocent change of position

In *Lipkin Gorman v Karpnale Ltd* [1991], the House of Lords recognised a broad defence of innocent change of position. Applying the relevant principles to the landlord and tenant context, the position is as follows. If a tenant makes a payment to its landlord under a mistake of fact or law and then the landlord, acting in good faith, pays the money or part of it over to a third party under a transaction which would not otherwise have taken place, the landlord will be able to set up a defence of innocent change of position against any restitutionary claim which might later be brought against it by the tenant. It should be noted that the landlord's payment over need not necessarily post-date the tenant's payment of service charge because the defence is available to a defendant who changes its position in anticipation of a particular payment.[4]

At first blush, it might be thought that a landlord, who has recovered more by way of service charge than it should, but who has nevertheless paid away the money to its contractors, managing agents, professionals etc would always be able to set up a defence of innocent change of position in answer to the tenant's restitutionary claim. However, on closer inspection, the availability of the defence is likely to be more limited for a number of reasons:

1) The landlord's expenditure must be 'extraordinary' (ie something that the landlord would not otherwise have incurred). Thus the payment of existing debts to contractors, professionals etc for services that the landlord was already obliged to provide under the lease will not generally enable the landlord to avail itself of the defence.

2) It will often be difficult for the landlord to establish the necessary causal connection between the receipt (or expectation of receipt) of the overpayment on the one hand and the landlord's expenditure on the other. The landlord will need to be able to persuade the court that if the tenant had not paid the full amount demanded, the landlord would not have incurred the expenditure anyway and then sued the tenant for the unpaid service charges.

3) The defence of innocent change of position is not available to a defendant who has acted in bad faith.[5] The latter will include dishonesty on the part of the recipient, but is:

> '... also capable of embracing a failure to act in a commercially acceptable way and sharp practice of a kind that falls short of outright dishonesty.'

If, at the time the payment is made, the landlord knows full well that the tenant has paid more than was due under the lease, but chooses to say nothing, it might well find that its intended defence of innocent change of position founders on bad faith grounds. Similarly, a landlord who demands payment of service charge from the tenant and is later unable to point to at least some arguable basis for asserting that the tenant was liable to do so may likewise find that the defence of innocent change of position is not available to it.

Estoppel

A landlord may also be able to avoid having to give restitution of the overpayment by setting up the defence of estoppel. Payment

of service charge by the tenant (without protest) might be said to amount to an implied representation that the landlord is entitled to treat the money as its own. If the landlord then relies to its detriment on that representation, the court may be prepared to hold that the tenant is estopped from seeking to recover it by means of a claim for unjust enrichment.

However, the landlord may again face a difficult task in persuading the court that expending the money on services which it was already obliged to provide under the lease is sufficient to found an estoppel. Moreover, unlike the defence of innocent change of position, estoppel is an equitable defence and its availability is therefore ultimately a matter for the court's discretion. In cases where the root cause of the overpayment is a demand made by the landlord for a sum that exceeds the tenant's contractual liability, the landlord may have a hard time persuading the court that it should exercise its discretion in the landlord's favour.

Limitation

A claim for restitution on the grounds of unjust enrichment is subject to the ordinary six-year limitation period for actions on a simple contract in s5 of the Limitation Act 1980.[6] Accordingly the tenant's claim to recover overpaid service charge will ordinarily be time-barred if not brought within six years of the payment being made. However, s32(1)(c) of the Limitation Act 1980 defers the commencement of the limitation period of an action for relief from the consequences of a mistake:

> '... until the plaintiff has discovered the... mistake... or could with reasonable diligence have discovered it.'

Accordingly, the limitation period for the purposes of a claim to recover service charge paid by mistake will not commence until the earlier of (i) the date on which tenant actually discovers its mistake and (ii) the date by which the mistake could with reasonable diligence have been discovered by the tenant.

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ALTERNATIVES TO RESTITUTION

A claim for restitution of a tenant's overpayment is not necessarily the tenant's only route to recovery. In an appropriate case, the overpayment may be recovered by one or more of the following means.

Reliance on the express terms of the lease

The lease may contain express provision about how overpayments of service charge are to be treated. Although provisions

NOTES

1) A tenant's claim for restitution of overpaid rent or service charge may be set off against a landlord's claim for later rents or service charge: *Fuller v Happy Shopper Markets Ltd* [2001].
2) See *Electricity Supply Nominees Ltd v IAF Group Ltd* [1993]; see also *Star Rider Inntrepreneur Pub Co* [1998].
3) See *Marine Trade SA v Pioneer Freight Futures Co Ltd BVI* [2009].
4) See *Dextra Bank & Trust Co Ltd v Bank* [2001]; *Commerzbank AG v Gareth Price-Jones* [2005].
5) See *Niru Battery Manufacturing Co v Milestone Trading Ltd (No 1)* [2002].
6) See *Re Diplock* [1948]; *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1994].
7) See *Quirko Investments Ltd v Aspray Transport Ltd* [2012]; see also *Capital & City Holdings Ltd v Dean Warburg Ltd* [1989].
8) The fact that break clause also required the tenant to pay a premium was thought by the court to make it unlikely that the parties intended the landlord to obtain to receive any additional windfall.
9) See *Nurdin & Peacock Plc v D B Ramsden & Co Ltd* [1999].
10) Section 21(1)(b) of the Limitation Act 1980; *Warwickshire Hamlets v Gedden* [2010].

Capital & City Holdings Ltd v Dean Warburg Ltd
[1989] 1 EGLR 90

Commerzbank AG v Gareth Price-Jones
[2005] Lloyds Rep 298

Dextra *Bank & Trust Co Ltd v Bank*
[2001] UKPC 50

Electricity Supply Nominees Ltd v IAF Group Ltd
[1993] 2 EGLR 95

Fuller v Happy Shopper Markets Ltd
[2001] 1 WLR 1249

Kleinwort Benson Ltd v Lincoln CC
[1999] 2 AC 349

Lipkin Gorman v Karpnale Ltd
[1991] 2 AC 548

Marine Trade SA v Pioneer Freight Futures Co Ltd BVI
[2009] EWHC 2656

Marks & Spencer Plc v BNP Paribas Securities Services Trust Company (Jersey) Ltd
[2013] EWHC 1279

Nurdin & Peacock Plc v D B Ramsden & Co Ltd
[1999] 1 WLR 1249

Niru Battery Manufacturing Co v Milestone Trading Ltd (No 1)
[2002] All ER 705; affirmed [2004] QB 985

Quirko Investments Ltd v Aspray Transport Ltd
[2012] 2 P&CR 71

Re Diplock
[1948] 465

Star Rider Inntrepreneur Pub Co
[1998] 1 EGLR 53

Warwickshire Hamlets v Gedden
[2010] UKUT 75 (LC)

Westdeutsche Landesbank Girozentrale v Islington London Borough Council
[1994] 4 All ER 890

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of this kind are usually designed to deal with the position which obtains where the interim service charge paid by the tenant during the year exceeds its year-end liability, they may, depending on their terms, be broad enough to encompass other types of overpayment.

Reliance on an implied term of reimbursement in a break clause

Break clauses are sometimes expressed to be conditional upon the tenant having paid all the rent and service charge due under the lease as at the break date. Where service charge is payable in advance, a requirement of this kind will often mean that the tenant pays service charge in respect of a period that post-dates the termination of the lease. While the tenant will need to pay the full amount to ensure the effective exercise of the break clause, it may then wish to be reimbursed a proportionate part of the service charges paid. Until recently, attempts by tenants to recover their overpayments have failed.[7] However, in *Marks & Spencer Plc v BNP Paribas Securities Services Trust Company (Jersey) Ltd* [2013], the court held that it was an implied term of the lease that the landlord would give restitution of the rent and service charge paid insofar as it related to the period after termination of the lease.[8] Although much will depend on the terms of the particular break clause, other tenants may now be able to follow suit.

Agreement to reimburse arising at the time of payment

Sometimes the landlord and the tenant agree between themselves that the tenant will pay now, but the landlord will reimburse the tenant if and to the extent that a court, tribunal or arbitrator later determines that the tenant has paid too much. Agreements of this kind, which may be express or implied from conduct[9], will give rise to a free-standing contractual right for the tenant to recover the overpayment if vindicated at trial.

Breach of trust

It is not uncommon for leases to contain an express provision that funds contained in the reserve fund or service charges generally are held by the landlord or alternatively a management company on trust for the tenants on terms which oblige the trustee to apply the funds towards the provision of the services required under the lease. Section 42 of the Landlord and Tenant Act 1987 implies a term to like effect into residential leases. If the landlord or management company expends moneys held in the reserve funds otherwise than for the purposes for which the lease provides, the tenant may be able to recover those moneys by means of a claim for breach of trust. Framing the claim as one for breach of trust, rather than unjust enrichment, has the advantage of side-stepping the availability of the defence of innocent change of position. Moreover, there is no limitation period in respect of such a claim.[10]

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