Service Charge Miscellany

Paul Butt revisits the problems connected to the ownership and management of leasehold flats. He highlights the problems faced by landlords and management companies in complying with the protections laid down by the law for flat owners.

In a previous edition of First Comment (January 2012), we considered the trials and tribulations of owning a leasehold flat and recommended using experts to deal with the management of the building.

In thisarticle we look at a couple of recent court decisions which emphasise the problems faced by the experts and that would be faced by the flat owners themselves if they decided to carry out the management of the block themselves.

Disputes between flat tenants and landlords/management companies/managing agents over service charges are not uncommon. There are wide ranging protections given to flat tenants with regard to these and it is now becoming very common for these disputes to end up in court or tribunal proceedings involving the application of these protections and alleged failures to comply with them.

Need for consultation - £250 per tenant limit - Phillips v Francis [2012] EWHC 3650 (Ch)

One of the protections given to flat owners is the right to be consulted by the landlord in certain circumstances before works are carried out.

This case concerns an estate of over 150 holiday chalets let on 999 year leases in Cornwall. This was subject to the same requirement for the landlord to consult the tenants over the carrying out of works which, when charged to the service charge account, would result in a cost of £250 or more for each tenant as laid down by s 20 of the Landlord & Tenant Act 1985 as amended by the Commonhold and Leasehold Reform Act 2002.

If the proper consultation procedures are not followed, the maximum amount the landlord can recover in relation to those works is £250 per tenant – which might be much less than the actual cost of the works to the landlord.

In 2008, the new owner of the estate started carrying out extensive works to the site to bring it up to a 'first class' standard. The costs of these works resulted in a considerable increase in the service charge payable by the tenants. Subsequently, some of the tenants applied to the county court, disputing the amount of the service charge.

One of the matters in dispute was the applicability of s 20 to the works. The judge decided that s 20 did not apply as none of the individual items of work carried out breached the £250 limit.

The judge relied on the previous Court of Appeal decision in Martin v Maryland (1999) in which the issue was considered.

The Court of Appeal laid down the following approach:

a) "A common sense approach was necessary as Parliament has not made it clear how to make a division, if at all, between works being undertaken.
b) Extreme fragmentation of works in a major scheme of development "plainly would be absurd".
c) The fact all the works were covered by one contract is not a decisive factor.
d) The legislative purpose of the limit on recovery in the absence of consultation is to provide a triviality threshold rather than to build into every contract a "margin of error."

In the original Act the limit on the recoverable service charge was an amount for the cost of the works, unless the landlord had complied with the consultation for which the original Act provided.

That was changed by the amendments made by the Commonhold and Leasehold Reform Act 2002 by fixing the limit by reference to the amount of the contribution sought from the tenant rather than the cost of the works. The following paragraphs are taken from the Chancellor's decision:

35. *"Thus the emphasis has shifted from identifying and costing the works before they start to notifying an intention to carry out the works and limiting the amount of the individual contributions sought to pay for them after their completion. Accordingly, I see nothing in the present legislation which requires the identification of one or more sets of qualifying works. If the works are qualifying works it will be for the landlord to assess whether they will be on such a scale as to necessitate complying with the consultation requirements or face the consequence that he may not recoup the cost from the tenants' contributions.*

As the contributions are payable on an annual basis then the limit is applied to the proportion of the qualifying works carried out in that year. Under this legislation there is no 'triviality threshold' in relation to qualifying works; all the qualifying works must be entered into the calculation unless the landlord is prepared to carry any excess cost himself."

36. "In my view the legislation in point on this appeal entitles me to construe it in the foregoing manner unconstrained by the conclusion of the Court of Appeal in Martin v Maryland Estates, save in its reference to the need to use common sense.

In addition such a construction conforms more closely to the ongoing works of repair and maintenance likely to be necessary on an estate in multiple occupation. They are unlikely to be identified as parts of a complete set of works which can be costed at the outset. In the normal way they will be carried out as and when required. The need for some limitation on an obligation to contribute is at least as necessary with sporadic works of that nature as with a redevelopment plan conceived and carried out as a whole."

37. *"Accordingly, in my judgment the judge applied the wrong tests when seeking to apply the 1985 Act. It is not disputed that all the works he considered in paragraphs 361 to 367 were qualifying works within the statutory definition.*

Accordingly, all of them should be brought into the account for computing the contribution and then applying the limit. It may be that they should be spread over more than one year thereby introducing another limit. With that exception, the

provisions relating to this service charge do not require any identification of 'sets of qualifying works' or the avoidance of 'excessive fragmentation'."

So where does this leave us – or rather leave landlords and managing agents – as far as consultation is concerned? The decision must be complied with. No longer can landlords simply look at an individual item of work and consult on that if the cost will exceed the limit. The landlord must add together the cost of all 'works' to be undertaken during the year and if the total cost of those results in a charge to the tenants exceeding the £250 limit, then consultation will be required.

And 'works' will presumably mean scheduled repairs to the building, regular maintenance and servicing of the lifts, heating equipment etc as well as the major works such as renewing the roof or resurfacing the car park or fitting replacement doors and windows which it was previously thought were the only things included.

The only things excluded will be services – cleaning, gardening, the cost of heating and lighting etc. Presumably this will mean that if the limit is reached virtually everything will be subject to consultation, thus adding to the costs to be met by the tenants.

There is also going to be the problem of works spread over a number of years e.g.: a rolling programme gradually to replace all doors and windows. This previously would have been subject to consultation based on the total cost. Presumably now the cost to be incurred in each year must be calculated and then included in the annual figures to determine whether consultation is required. This might actually result in no consultation being required!

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Incidentally, it is understood that the decision is not to be appealed, so further clarification by the Court of Appeal will have to wait for another time and another dispute.

Dispensation with the consultation requirements - Daejan Investments Ltd v Benson [2013] UKSC 14.

However, it is possible for landlords etc. to apply (either before or after the event) for some or all of the consultation procedures to be dispensed with. And the Supreme Court has now ruled on the approach to be adopted when a court is faced with such an application.

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Facts

The claimant was the freehold owner and landlord of flats (the property) leased by the defendants. The defendants applied to the LVT for a determination of the service charges payable under their respective leases after a tendering process for major works to be carried out at the property had closed before the defendants had had an opportunity to inspect estimates of the costs and thus the consultation requirements had not been complied with. The Court of Appeal, Civil Division, held that the Lands Tribunal had been entitled to conclude that the claimant landlord had committed a 'serious breach' and to refuse dispensation with the consultation requirements under the Landlord and Tenant Act 1985, s 20ZA(1).

The claimant appealed. The Supreme Court, in allowing the appeal, held that the lower courts had adopted the wrong approach to the claimant's s 20ZA(1) application. The correct question to be asked was, whether the defendants would suffer any relevant prejudice, and, if so, what relevant prejudice, as a result of the claimant's failure, if the s 20(1)(b) dispensation was granted unconditionally. On the facts, the claimant's application for a dispensation under s 20(1)(b) of the Act should have been granted. The orders by the lower courts were set aside and the dispensation was granted.

Practical Implications

When considering a landlord's application for dispensation from a failure to fully comply with the consultation requirements under the Landlord and Tenant Act 1985, s 20 and the Service Charges (Consultation Requirements) (England) Regulations 2003, SI 2003/1987, the Leasehold Valuation Tribunal (LVT) must now consider whether there has been any prejudice to the tenants as a result of that failure.

If there has been prejudice then the LVT can grant dispensation on the condition that the tenants are compensated for any such prejudice, which is likely to be by way of an appropriate reduction in the costs of the works and payment of the tenants reasonable costs incurred in dealing with the landlords dispensation application.

This decision has widened the LVT's discretion when considering dispensation applications, which previously has been to either grant dispensation unconditionally or refuse it. The Supreme Court stated that the purpose of the legislation is to protect tenants from paying for inappropriate works and an unreasonable amount for the works, not to give them a windfall due to the landlord's failure to fully consult.

A tenant needs to show a credible case that there has been some relevant prejudice and identify what they would have done and in what way they have been prejudiced, if the failure complained of had not occurred. It is no longer the case that the failure to fully consult is itself a prejudice, or that the granting of dispensation is dependent on whether the non-compliance was minor or serious.

Once the tenant has shown a credible case that there has been some relevant prejudice it is then down to the landlord to show the prejudice relied upon by the tenant is of no consequence, failing which the LVT is likely to only grant dispensation on terms, unless there is good reason not to.

The LVT needs to try to ascertain what would have happened had the consultation process been properly followed in deciding what terms, if any, to impose. What impact will the ruling have on landlords who have to go through a s 20 consultation when planning works?

Obviously, landlords must still be advised to fully comply with the consultation requirements. This ruling does not alter that requirement. Any failure will amount to non-compliance and unless dispensed with the landlord will only be able to recover £250 from each tenant. This decision does not in any way give the landlord any rights not to comply. This ruling simply provides the landlord with an ability to obtain relief, on terms, from the statutory sanction of not fully complying. It does not however guarantee such relief will always be granted.

While the LVT is to be sympathetic to a tenant who can show relevant prejudice, dispensation is likely to be given if that prejudice can be compensated by terms being attached to the grant of any dispensation. Those terms will still have an adverse impact on the landlord who has to cover both its own and the tenant's costs of the dispensation application and cover any reductions required to the costs of the works.

There is no certainty as to what the conditions may actually be. Landlord clients should always, therefore, be advised to ensure they fully comply with the Consultation Regulations.
Although this ruling offers some comfort to landlords who have failed to fully comply with the Consultation Regulations, a landlord is still likely to suffer as a result of any failure should dispensation only be granted on condition and indeed still runs the risk of dispensation not being granted at all.

More problems, more uncertainty for all those concerned in owning and running blocks of flats. And don't forget, many flat tenants own the management company that is responsible for repairing the flats; these provisions (and problems) apply just as much to them as to any commercial landlord or management company.

Paul Butt LLB is a Solicitor and a Consultant with Rowlinsons Solicitors, Frodsham.