

The following cases are referred to in this decision:

London Borough of Brent v Hamilton (Lands Tribunal ref LRX/51/2005, 23 October 2006, unreported)

Investors Compensation Scheme v West Bromwich Building Society [1998] 1 WLR 896

Bank of Credit and Commerce International SA v Ali [2002] 1 AC 251

Charrington and Co v Wooder [1914] AC 71

Gilje v Charlegrove Securities Ltd [2002] 1 EGLR 41

The following further cases were referred to in argument:

The Moorcock (1889) 14 PD 64

Embassy Court Residents Association v Lipman [1984] EGLR 60

DECISION

1. This is an appeal by the landlord against the decision of a leasehold valuation tribunal dated 10 May 2007 on an application made to it by the respondent under section 27A of the Landlord and Tenant Act 1985. The respondent is the lessee of a flat, 5 West Pottergate, Norwich, under a lease for 125 years dated 29 June 1987 granted by the appellant under the Right to Buy provisions of the Housing Act 1985. In his application to the LVT he sought a determination of his liability for service charges for past, current and future years from 2002/03 to 2010/11. He stated the item of service charge in issue to be: "Leaseholder Management Fee – currently set at £40." He asked that, if the landlord was held to have the right to levy a management fee, the LVT should determine a fair rate for future years. The LVT determined the application on the basis of written submissions by each of the parties. The LVT held that the council could not recover the leaseholder management fee by way of service charges under the lease because no express provisions for this had been made.

2. The council sought permission to appeal against the decision on the grounds that the LVT had failed properly to consider the meaning of the provisions of the lease and had therefore failed to consider fully whether the management costs were recoverable; that it failed in construing the lease to take into account the context in which it was demised; and that it failed to take into account the decision of this Tribunal in *London Borough of Brent v Hamilton* (Lands Tribunal ref LRX/51/2005, 23 October 2006, unreported). I granted permission to appeal.

3. Under clause (3) of the lease the lessee covenants with the council:

"(3) without prejudice to the provisions to the provisions of Paragraphs 16B C and D of Schedule 6 of the Act and Sections 18 to 30 of the Landlord and Tenant Act 1985 to pay such sums of Service Charge as are payable in accordance with the provisions of Schedule C."

4. "Service Charge" is defined in Schedule C to mean:

"such percentage as shall from time to time be far share as determined by the Council's Housing Manager or such other officer of the council as shall be appropriate of the Council's Expenditure attributable to the Property proportionate to the number and/or size of the properties from time to time comprised in the Building ..."

5. The definition in the Schedule of "the Council's Expenditure", so far as relevant, is:

"the reasonable expenditure of the Council (including interest paid on any money borrowed for that purpose):-

(a) in complying with its obligations set out in clause 6(1) (2) and (9) and excepting expenditure incurred in carrying out repairs as amount to the making good of structural defects already notified to the Lessee or of which the Council does not become aware earlier than 10 years from the date of this Lease ..."

6. The council's obligations set out in clause 6(1), (2) and (9) are as follows:

“(1) without prejudice to clause 6(9) to keep in repair (including decorative repair) the structure and exterior of the Property and the Building including the gas water and other pipes mains cables wires appliances flues drains water and other apparatus forming part of or on in under or over the Building but used other than exclusively in connection with the Property and all drains gutters and external pipes (whether within the Property or not) and to make good any defects affecting that structure.

(2) to keep in repair any other property over or in respect of which the Lessee has rights as specified in Schedule A...

(9) to ensure so far as practicable that the services to be provided by the Council as specified in Schedule D are maintained at a reasonable level and to keep in repair any installation connected with the provision of such services.”

7. Schedule D “(details of services provided)” comprises this:

“The provision maintenance repair and renewal of the lighting to the communal areas on the Estate and the electricity consumed in respect thereof.

The provision of horticultural planting and maintenance of the communal gardens and/or landscaped areas on the Estate.”

8. Schedule A, which is referred to in clause 6(2), specifies as rights of the lessee such matters as the right of support and to the passage of water and gas, and it includes rights to pass over the pathways and passages of the estate and the common parts of the building and to use and enjoy the communal gardens and landscaped areas.

9. In its decision under the heading “Written submissions” the LVT summarised the contentions of the parties. At paragraph 17 it said that those of the council included a breakdown headed “Reasonable Recoverable Costs based on 2006/07 original estimates”. It commented:

“Divided by the average number of leaseholders over the course of that year of 2431.5 the end result, a cost per dwelling of £151.16, may not seem much out of line with what a professional managing agent would charge per housing unit for the general administration of a building or estate and the handling of insurance issues, etc. However, amongst the costs are the employment of a Home Ownership Team, Tenancy Services, some senior management, agency and ‘central services’ costs (including £4,608 spent on ‘publicity/dealing with media’) and corporate/professional services including legal services, asset management, financial services (at a cost of £17 per lessee for issuing invoices), office accommodation, employee insurance and transport and consumables.”

10. Under the heading “Discussion and findings” the LVT said:

- “19. As already stated above, the starting point when considering this question is to look at the express provisions of the lease. A landlord offering a lease to a prospective lessee can make as detailed (and generous – to itself) provision as it wishes as to costs incurred in respect of the building which are to be recoverable from the lessees as a body by way of service charge. The only limit to this generosity is that the costs must be reasonably incurred. However, if no provision is made for a particular type of expenditure then it is not recoverable. The Respondent openly concedes that this lease makes no express provision for the recovery of the expenses of management. Whether it ought to, and whether as a result of this omission the service charge provisions of the lease are not satisfactory, are entirely separate questions which are not before this tribunal for determination.
20. What the Respondent invites the tribunal to do is to imply into the lease such a provision, but without stating precisely what administrative costs should be included. Should they include legal costs (and if so, for what) public relations, or a notional rent for the office accommodation at City Hall? Should they include expenditure incurred in connection with other leasehold flats outwith this estate, perhaps on the other side of the city?
21. Although the council had the opportunity to draft the service charge provisions in as much detail as it wished the lease includes no express term entitling the landlord to recover management fees. The landlord invites the tribunal to imply such a term into the lease, but without making clear exactly what expenditure such a provision should include. The lease refers to ‘the Property’, ‘the Building’ and ‘the Estate’. Express references to service charge expenditure are also so limited, yet that is not how the landlord chooses to calculate its administration costs. Even were the tribunal to consider implying some such term into the lease on grounds of business efficacy, that argued for by the landlord is too uncertain (and the current method of calculating its administrative costs so at odds with the spirit of the lease) and therefore fails the required test. There is therefore no lawful basis upon which the landlord may include within its annual service charge for the Applicant’s property any costs of management or administration.”

11. The appellant filed a witness statement by Paul Anthony Middleton Sutton, employed by the council as a Business Planning Manager, explaining the document “Reasonable Recoverable Costs based on 2006/07 original estimates” that was referred to in the LVT decision. Although this appeal is by way of review, Mr Marshall said that he saw no objection to me taking this statement into account. Referring to the document as “the Management Costs document” Mr Sutton said this about it:

“... This document lists the costs incurred by the authority in managing their leasehold properties. The first item listed in the Home Ownership Team Costs. The employees comprised in this team are listed under this heading; their annual salaries are given where appropriate. The Home Ownership Manager has estimated that she spends about 70% of her time dealing with pure leasehold issues (as opposed to right to buy issues).

The annual salary of the Right to Buy officer is £22,860. (06/07) Of this none has been allocated to management. The Right to Buy officer deals with the processing and management of right to buy applications.

The authority has 4 leasehold officers and 3 leasehold/right to buy assistants. The 4 leasehold officers are primarily and almost exclusively involved in dealing with leasehold management issues. They deal with matters such as consultation on major works, service charge statements, breaches of lease covenants, enforcement action, repair orders, permission application and so on. The three Leasehold/Right To Buy Assistants work with both sections (the leasehold section and the right to buy section). The cost of their salaries has been apportioned across the two teams on a 50/50 basis.

The next item on the Management Cost document is Tenancy Services. This is a call centre service, which operates Monday to Friday from 8am until 6pm. It is serviced from a pool of 75 staff. Of this 2% has been allocated to leasehold management costs, which is a conservative allocation. Similarly only 2% of the costs of the Senior Housing staff has been allocated to leasehold management issues. Again, this is a conservative allocation.

Three costs items are listed under 'Agency costs allocated on a per employee basis' – computers, telephones and pay roll management. The figure of 7.68 reflects the number of full-time staff we have in relation to leasehold management issues. There are six full time staff in the Home Ownership Team. In Tenancy Services there is the equivalent of 1.5 (06/07) full time employees and in Senior Management the equivalent of 0.18. With regard to computers, the authority has IT maintenance contract which services all of our IT needs. The cost of £8000 has been arrived at by dividing the cost of that contract by the number of computers the authority has. Thus, this cost has been assessed in conjunction with the numbers of employees that are employed in relation to leasehold management issues (which is the full-time equivalent of 7.68). The costs for telephone are notional amounts.

Three further items are listed under Central Service Costs allocated on a per employee basis. Essentially, these items are costs incurred by the authority to which each department has to contribute based on the number of employees it has on a full-time equivalent basis in their department.

The remaining costs items under Corporate/Professional Services serving Leasehold Services, Office Accommodation Costs and Employee Insurance are all self-explanatory. Where the costs have been apportioned I consider the apportionments to be conservative but realistic.

The total cost for 2006/7 was £367,540. The average number of long leasehold interest in that year was averaged at 2431.5. When the total cost is divided by the number of leasehold it can be seen that the real cost of is £151.16. The leaseholders are in fact charge £40 per year. In my view, there can be no doubt that at least this amount is incurred by the authority in complying with its obligations under the leases.”

12. For the council Ms Annette Cafferkey refers to the principles underlying the interpretation of contracts by reference to *Investors Compensation Scheme v West Bromwich Building Society* [1998] 1 WLR 896, *Bank of Credit and Commerce International SA v Ali* [2002] 1 AC 251, and *Charrington and Co v Wooder* [1914] AC 71. Ms Cafferkey says that the lease must be construed in relation to its context, which is its grant pursuant to the Right to Buy provisions of the Housing Act 1985. A purchaser under those provisions could not expect to have his service costs subsidised. She relies on *London Borough of Brent v Hamilton* as authority that expenditure incurred by a council in exercising management functions to their obligations under such a lease as the present one is recoverable as part of the service charge. Her primary submission is that “the reasonable expenditure of the Council ... in complying with its obligations set out in clause 6(1)(2) and (9)” in terms includes management costs incurred in so complying without the need to imply any term. Alternatively she says that a term should be implied to this effect.

13. The respondent Mr Marshall contends that the council are seeking a modern interpretation of a lease that was drawn up in 1987. At that time, he says, individual departments within the council were not charged or accountable for any notional costs such as rental on office space, telephone, payroll and human resources, not to mention senior management salaries. Such costs were covered in the overall accounting process and were seen as essential to the whole. This changed when in 1994/95, the council, along with other local authorities, adopted a process of accounting known as “asset rental”. Mr Marshall says that at the time the lease was drawn up there would have been no intention of including notional costs for office rental and proportions of senior management salaries or any other management charges. Those were deemed to be borne by the council and not by individual departments. Mr Marshall refers also to internal council memoranda that show that different views were taken as to the right to make charges for management.

14. The issue is principally one of construction. In cases such as this service charge provisions tend to be construed restrictively: see *Gilje v Charlegrove Securities Ltd* [2002] 1 EGLR 41, in which at para 31 Mummery LJ quoted with apparent approval a statement to this effect in the Encyclopaedia of Forms and Precedents. Laws LJ at para 27 said this:

“... The landlord seeks to recover money from the tenant. On ordinary principles there must be clear terms in the contractual provisions said to entitle him to do so. The lease moreover was drafted, or proffered, by the landlord. It falls to be construed contra proferentem ...”

15. The terms of the lease in the present case are in my judgment clear. The lessee is required to pay as a service a fair share of “the reasonable expenditure of the Council ... in complying with its obligations under clause 6(1), (2) and (9).” Under clause 6(1) the council must keep in repair the structure and exterior of the flat and the building in which it is contained; under clause 6(2) they must keep in repair the common parts of the building and the estate, and under clause 6(9) they must ensure that the lighting to the communal areas and the planting of the gardens and landscaped areas are maintained at a reasonable level. In complying with these obligations it seems inescapable that supervision and management costs will be incurred. As I said in *London Borough of Brent v Hamilton* at paragraph 11:

“If repairs are to be carried out or windows painted or staircases cleaned someone will have to be paid for doing the work and someone will have to arrange for the work to be done, supervise it, check that it has been done and arrange for payment to be made. Since the council can only act in these respects through employees or agents it will have to incur expenditure on all these tasks. If it does incur such expenditure, the lessee will be liable to pay a reasonable part of it.”

Management costs like this are in my view recoverable by reference to the council’s obligations under clause 6(1), (2) and the second part of (9), while the obligation under the first part of clause 6(9) – “to ensure so far as practicable that the services to be provided by the Council as specified in Schedule D are maintained at a reasonable level” – is in essence a direct requirement to exercise a management function. There is no need to imply any term. As a matter of construction such costs are provided for by the provisions of the lease.

16. Support for the approach that I set out in the *Brent* case is now to be found in *Wembley National Stadium Ltd v Wembley London Ltd* [2008] 1 P & CR 3, an action in the Chancery Division, in which, in relation to a dispute as to whether management costs were payable as part of a service charge under a lease of commercial premises, Morritt C said this:

“44. The principal dispute in this context was whether the costs of management might be included and if so to what heads of expenditure they might extend. For WNSL it was contended that provisions relating to service charges are restrictively interpreted, see per Mummery LJ in *Gilje v Charlgrove Securities Ltd* [2002] 1 EGLR 41, para 32. No doubt, too, it is appropriate for the interpretation to be more restrictive in the case of residential tenancies as opposed to a commercial transaction between two substantial parties. At all events I can find nothing in the wording of this Lease in general and the definition of ‘Expenditure’ in particular to confine the relevant services to the actual service to the exclusion of any management cost incurred in its provisions. Why, for example, should the wages of the employee who actually applied the tarmac to the surface of the car park be included but the salary of he who arranged for the employee to do it and for the tarmac to be available for such application be excluded. In my judgment the wording of the definition embraces both...

46. In relation to the heads of expenditure to which the cost of management might extend Mrs Viazzani set out a list in paragraph 17(b) of her witness statement. The list included office accommodation, training, medical insurance and pensions. It is said that these items of expenditure are all ingredients in the cost of providing the Lessor’s Services. It is contended on behalf of WNSL that such costs could not be shown to have been ‘properly incurred by the Lessor in complying with its obligations’. That does not appear to me to be a sufficient response to the contention of WLL. If such expenditure can be shown to have been so incurred I see nothing in the definition to exclude it. The further from actual compliance with the Lessor’s obligations the incurring of the cost or expense lies the less likely it will be that such expenditure was incurred ‘in’ such compliance. But I see no reason in principle to exclude indirect costs of management and corresponding ‘overhead’ expenses.”

17. In my judgment, therefore, the council is entitled to include in the service charge the costs of management reasonably incurred for the specific services referred to in clause 6(1), (2) and (9). Those, however, are the only management costs that it is entitled to include, and it appears from the explanation given in Mr Sutton's statement that the costs included in the Management Costs document go well beyond this. Thus they include all such costs of the Home Ownership Team as relate to "pure leasehold issues", and the four leasehold officers, whose salaries are included, are said to deal with breaches of covenants in leases, enforcement action, repair orders and permission applications, which are plainly outside the scope of the council's clause 6(1), (2) and (9) obligations, as well consultation on major works and service charge statements, which appear to be within the scope of those obligations. I can see no justification for implying any entitlement on the part of the council to charge for management costs other than those related to clause 6(1), (2) and (9).

18. Mr Marshall, as I have said, contended that in 1987 when the lease was drafted overhead costs such as the notional rent of office space, telephone, payroll and human resources were not charged to individual department, so that "the reasonable expenditure" of the council in relation to the matters for which service charges are payable ought not to be construed as extending to these costs. This contention had not been advanced before the hearing, and Ms Cafferkey on instructions responded that in the mid-1980s the housing revenue account was in fact charged with such items. It seems to me, however, that even if Mr Marshall is right on the facts, the provisions of the lease are clear. The "reasonable expenditure" incurred in providing the specified services can be included in the service charge, but other management costs cannot be included. What expenditure is reasonable for this purpose is a question of fact to be determined by the LVT.

19. The LVT rejected in its entirety the £40 management fee that the council had included in Mr Marshall's service charge. It was, for the reasons I have given, in my judgment wrong to do so, although its view that the matters to which charge related went beyond what the council were entitled to include was clearly right. Because of the approach that it adopted, the LVT made no findings of fact as to what expenditure was reasonably incurred by the council in complying with their obligations under clause 6(1), (2) and (9). The parties expressed agreement that in these circumstances, if I were to allow the appeal, the matter should be remitted to the LVT so that it could make the necessary determination. Accordingly, I allow the appeal and remit the matter to the LVT for this purpose. It will be for the council to adduce the evidence necessary to establish their case on the basis that I have concluded to be correct in law.

Dated 23 October 2008

George Bartlett QC, President