Neutral Citation Number: [2019] EWCA Civ 1827

Case No: C3/2018/1384

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE UPPER TRIBUNAL (LANDS CHAMBER)
MARTIN RODGER QC, DEPUTY CHAMBER PRESIDENT
[2018] UKUT 0092 (LC)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 29/10/2019

Before:

LORD JUSTICE McCOMBE
LORD JUSTICE COULSON
and
LADY JUSTICE NICOLA DAVIES DBE

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Between:

AVON GROUND RENTS LIMITED	**Appellant**
- and -	
(1) MRS ROSEMARY COWLEY AND OTHERS	
(2) METROPOLITAN HOUSING TRUST	
(3) ADVANCE	
(4) MAY HEMPSTEAD PARTNERSHIP	**Respondents**

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Justin Bates and Kimberley Kya (instructed by **Scott Cohen Solicitors**) for the **Appellant**
Timothy Clarke (instructed by **Legal Services**) for the **Second Respondent**
The **First, Third and Fourth Respondents** did not attend and were not represented

Hearing date: Thursday 10 October 2019

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Approved Judgment

Lady Justice Nicola Davies:

1. This is an appeal in respect of a decision of the Upper Tribunal (Lands Chamber) (Martin Rodger QC, Deputy Chamber President) [2018] UKUT 0092 ("the UT") which was a decision made on appeal from the First-Tier Tribunal (Property Chamber) ("the FTT").

2. Two grounds of appeal are raised. The first is as follows: where there exists an anticipated schedule of works, the total costs of which are reasonable and there is a possibility of a third-party making a contribution to those costs, in assessing the residential service charge payable in advance in respect of those works, does section 19(2) of the Landlord and Tenant Act 1985 ("the 1985 Act") require a landlord (depending on the facts of each case):

    i) to give credit for the anticipated payment when assessing the reasonable amount to be credited on account; or

    ii) to take account of third-party payments only when they are received and thereafter apply those monies as balancing the charge back to the leaseholders?

3. The second ground of appeal relates to the order made pursuant to section 20C of the 1985 Act by the FTT, whereby it concluded that a 50 per cent reduction in the appellants' recoverable costs was justified.

Background

4. The appellant is the freehold owner of "the Interchange", a mixed commercial/residential development comprising a basement, ground and four upper floors arranged around a central courtyard. It was completed in 2008 and subsequently let to a number of different lessees on terms requiring them to contribute through a service charge to its repair and maintenance.

5. The freehold interest in the building was acquired by the appellant in March 2015. The first respondent is the long leaseholder of one of the flats in the building, she has acted in the proceedings as a representative of the leaseholders of a further 34 flats, all of whom are private individuals. The second respondent is the leaseholder of the remaining fifteen flats, which it holds under a single lease. At the hearing of this appeal the second respondent was represented. The first, third and fourth respondents did not appear and were not represented.

6. In July 2015 the appellant became aware that water was penetrating through the surface of the central courtyard into one of the two commercial units in the basement, let respectively to the third and fourth respondents. Surveyors were instructed and concluded that the membrane beneath the courtyard had failed and that a new waterproofing layer was needed. Liability for repairing the defect fell upon the appellant who, in principle, is entitled to recover the costs of the remedial works from the two commercial tenants and from the lessees of the 49 residential flats on the upper floors of the building.

7. The relevant terms of the lease were identified in the UT judgment as follows:

> "7. The leases of the different units of occupation at the development are in substantially the same form so far as service charges are concerned. Each leaseholder is required to contribute towards expenditure by the landlord in connection with the repair, management and maintenance of the building and the provision of services. The services are divided into three categories, with leaseholders contributing a different 'specified proportion' of expenditure in either two of these categories, or in all three, depending on usage. To take the lease of one of the private residential flats as an example, the leaseholder of Flat 10 is required to pay 1.93% of the 'Building Provision', 1.44% of the 'Estate Provision' and 2.94% of the 'Residential Common Parts Provision'.
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> 8. In the private residential leases and in the third respondent's lease of Unit 1 the required contribution to each category of expenditure is a fixed percentage, as is the contribution of the second respondent to the Building Provision. The second respondent's contribution to the Estate Provision is not fixed, but is to be a 'fair and reasonable proportion.' Similarly, the fourth respondent, as leaseholder of Unit 2, is required to pay 'a fair proportion' of both the Building Provision and the Estate Provision.
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> 9. By clause 6.2 of each of the leases the leaseholder has covenanted to pay the Service Charge by quarterly payments in advance. The amount payable is the aggregate of the specified proportions of the Building Provision, the Estate Provision and (in the case of the private residential leases) the Residential Common Parts Provision, which are to be estimated at the start of the 'Account Year' beginning on 25 June. Each of the component Provisions is to comprise 'the reasonable and proper expenditure estimated by the landlord as likely to be incurred in the Account Year by the landlord upon the matters specified in sub-clause 6.5.' At the end of each Account Year the appellant is required to determine 'the amount by which the estimate … shall have exceeded or fallen short of the actual expenditure in the Account Year' (clause 6.5); each leaseholder is then required to pay its specified proportion of any shortfall or is entitled to an allowance reflecting any surplus as the case may be.
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> 10. The matters specified in sub-clause 6.5 as being the subject of service charge expenditure include the cost of repairs and other usual services. They also include 'any interest and fees in respect of money reasonably borrowed to finance the provision of the services.'"

8. Sub-clause 6.6 of the lease stated that:

> "6.6. As soon as practicable after the end of each Account Year the Landlord shall determine and certify the amount by which the estimate referred to in paragraph (a) of sub-clause (4) of this Clause shall have exceeded or fallen short of the actual expenditure in the Account Year and shall supply the Leaseholder with a copy of the certificate and the Leaseholder shall be allowed or as the case may be shall pay within 15 days of receipt of the certificate of the Specified Proportion of the excess or the deficiency."

9. In January 2016 the appellant's agents gave the residential leaseholders notice under section 20 of the 1985 Act that it intended to carry out remedial work to cure the defect, and invited their observations. It is common ground that any amounts found to be due by the leaseholders would fall within Estate Provision.

10. In the same month the appellant's agents notified the National House Building Council insurance scheme ("NHBC") of a claim. The property is the subject of three separate NHBC warranties which apply to different parts of the structure. A 'Buildmark' warranty covers the private residential flats owned by the first respondents and gives cover for defects above a certain minimum value but without any uninsured excess. A separate "Buildmark Choice" warranty provides cover for the 15 flats held by the second respondent, but applies an irrecoverable excess totalling £14,595 for all 15 units. The two commercial units are covered by a third warranty, "Buildmark Link", with an excess of £3,880 per unit.

11. On 10 June 2016 the appellant's agent issued demands for the first instalment of service charges for the year beginning 25 June 2016 which included each leaseholder's apportioned part of the cost of the remedial works, the total sum was estimated to be £291,008.

12. Subsequent developments are set out in the UT's judgment:

> "16. In subsequent exchanges between the appellant's agent and NHBC it sought to identify under which of the three Buildmark warranties the claim was being made, as that was relevant to the amount of the excess which would be applied. Possibly because of difficulty in ascertaining exactly where the defect had occurred, that question was not one which the appellant was immediately able to answer. It was also of concern to NHBC to establish in what proportions each of the leaseholders were obliged to contribute; it is less clear why so much importance was placed on this.
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> 17. NHBC does not appear at any stage seriously to have disputed its liability to contribute towards the cost of the necessary remedial works, but it has not yet been prepared to commit itself to paying a specific sum. Its position before the first instalment of the advance payments fell due can be seen from the following extract from an email sent on 8 June 2016 to the appellant's agents:

> 'In principle we find the claim to be valid as there is damage caused by a defect which is principally what all three policy types cover. What we cannot do at this stage is confirm our liability on each policy type, the excess owed on each policy type and our contribution to each policy types' liability. Once the tribunal has ascertained apportionment I can advise exactly what NHBC will be liable for.'

18. NHBC's reference to the tribunal was to the FTT, at which the appellant had issued two applications under the Landlord and Tenant Act 1985 on 31 March 2016. The first was under section 27A(3) and raised specific questions concerning the appellant's proposed remedial scheme and the liability of the leaseholders to contribute towards it, while the second sought dispensation under section 20ZA from the statutory consultation requirements in the event that they had not been completed properly.

19. The appellant's section 27A(3) application asked the FTT to consider its entitlement to a service charge if it were to incur the costs of the proposed remedial works, estimated to be a little over £291,000, and to determine the liability of each respondent to pay their due proportion of those costs. The determination was said to require consideration of the proportions applicable to each respondent, the reasonableness of the proposed costs, and the adequacy of the section 20 consultation procedures.

20. In its statement of case and evidence for the FTT the appellant did not make it clear under which category of expenditure it considered the cost of the remedial works fell. Nevertheless, in the estimate of expenditure provided with the demand for the first instalment of the advance service charge served on 10 June 2016 the apportionment appears to have followed the proportions applicable to the Estate Provision. It certainly did so in the case of the second respondent, which was charged 25.95% of the total, that being the percentage which had always been treated by the appellant as the second respondent's fair and reasonable contribution towards Estate matters. The basis on which the other leaseholders were charged is less clear, as only the demands themselves have been produced and not the breakdown, but it seems reasonable to assume that the same principle was applied.

21. Applying the Estate Provision proportions to the total of £291,000 which the appellant sought to recover in advance by quarterly instalments from June 2016, each of the private residential leaseholders would be required to contribute between £3,114 and £6,286 (£778 to £1,571 per quarter) while the second respondent was asked to pay £75,514 (or £18,878

> per quarter). These are relatively substantial sums, especially for the individual leaseholders.
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> 22. The appellant has made it clear at each stage of the proceedings that it is willing to apply the proceeds of the NHBC warranty to the service charge account when they were received."

The FTT decisions

13. The FTT issued an interim decision in which it recorded that the appellant and the first and second respondents had reached agreement as to the obligations of the two respondents to contribute to the costs and percentage contributions. The FTT determined that it had no jurisdiction over the third and fourth respondents as they were not residential leaseholders. The FTT was satisfied that the works were a "reasonable approach" based on "reasonable investigative steps" and represented a "reasonable solution based on professional advice". The FTT also determined that if the estimated costs of £291,954.64, together with the fees of surveyor and managing agents, were incurred these would be recoverable through the service charge paid by each respondent "subject in each case to deductions first in respect of insurance receipts from NHBC".

14. The FTT, having determined that pursuant to section 27A of the 1985 Act, it had to determine the amount which each leaseholder was obliged to pay, was unable to make the relevant finding until the contribution to be made by the NHBC was known. It directed the appellant to apply to the tribunal within two months with details relevant to that issue so as to enable a final determination to be made as to the specific sums which each of the first and second respondents were required to contribute.

15. On 17 March 2017 NHBC acknowledged liability for the full costs of the repair and said that it would offer a further 7.5 per cent for project management plus a ten per cent contingency on the understanding that its offer would be in full and final settlement. There remained some uncertainty regarding the position of the third and fourth respondents. The aggregate sum which NHBC proposed to offer was £296,046. The total value of the first respondents' claims under the warranty was £145,210 which NHBC said it would meet in full, as their Buildmark Warranty was not subject to an excess. The second respondent's entitlement was reduced by the amount of the Buildmark Choice Excess, leaving a net contribution by NHBC of £62,228. In respect of the commercial occupiers it was assumed they would be liable in equal proportions and on that basis, having made an allowance for the excess under the Buildmark Link Policy, NHBC indicated its intention to contribute to £33,125 for each unit.

16. By an email dated 12 April 2017 NHBC made clear to the appellant that confirmation from all parties that the proportions were agreed was required before it would make a cash settlement in the proposed amounts. The appellant's solicitors informed the FTT of the position and of the fact that only the contribution of the fourth respondent was unascertained, however it provided no information as to the state of negotiations between the fourth respondent and the appellant. By a letter dated 25 April 2017 the appellant's solicitors repeated their assurance that the proceeds of the NHBC warranty would be applied to the service charge account when they were received, however

pending those receipts they invited the FTT to determine that the contributions of each of the leaseholders within the jurisdiction of the tribunal were payable in full without taking into account the anticipated NHBC receipts.

17. In its final decision (4 June 2017) the FTT determined:

    i) The contribution required from the first respondents towards the cost of the remedial work was nil as the NHBC was liable to pay the full amount apportioned to the private residential leases;

    ii) The second respondent was liable to pay £11,697.98 to the appellant, taking into account the NHBC contribution net of excess.

    It follows from those determinations that the FTT rejected the appellant's contention that no allowance should be made for the anticipated monies from the NHBC. The FTT also considered an application pursuant to section 20C of the 1985 Act, having regard to the extent of the parties' respective successes. It concluded that not more than half of the costs incurred by the appellant in connection with the proceedings should be passed onto the first and second respondents through the service charge.

The Upper Tribunal

18. In considering the appeal the UT held that the sums in issue, which are payable in advance based on an estimate of anticipated expenditure before any of the remedial work had been done, are subject to the provisions of section 19(2) of the 1985 Act (quoted in full in paragraph 22 below).

19. Having considered a number of authorities as to the application of section 19(2), the UT concluded that there was no reason why the prospect of a receipt from a third party must be certain before it may be taken into consideration in determining the reasonableness of an advanced payment. It found there was no disagreement between the appellant and the second respondent as to the proportion which it was obliged to contribute towards estate provision and the liabilities of the first and third respondents were fixed. The only disagreement as at the date of the UT proceedings concerned the contribution of the fourth respondent. However, the tribunal found that as the appellant chose to tell both the FTT and the UT nothing as to the state of negotiations between it and the fourth respondent there was no reason to assume that they would present a stumbling block to the final agreement within a reasonable time.

20. The UT determined that the FTT was entitled to conclude that, as at June 2016, a contribution equal to the full cost of the remedial works was not a reasonable advanced payment in circumstances where a payment of a near equivalent amount was anticipated from NHBC and there was no reason to believe it would be delayed. The appeal having been dismissed upon the primary issue, the UT determined that there was no reason to interfere with the FTT's exercise of its discretion in relation to the section 20C application.

Developments since the UT decision

21. The appellant and the fourth respondent have now agreed the proportion of costs payable under the relevant lease. As a result, the precondition identified by the

NHBC is met. The NHBC has made a part-payment towards the cost of the works. The appellant contends that this does not render the case academic as the FTT and the UT erred in holding that the potential NHBC payments could be taken into account. If that is correct, then the appellant would have been the successful party in the litigation below, such that there could be no proper reason for depriving it of its contractual right to costs.

Ground one

22. The appellant contends that the FTT and the UT correctly held that under the residential leases the first and second respondents were required to pay the whole of the sum demanded, namely their proportions of the cost of the remedial works on account. However, each tribunal erred in finding that section 19(2) of the 1985 Act affected the position. Sections 19(1) and (2) of the 1985 Act state:

> "19 Limitation of service charges: reasonableness.
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> (1) Relevant costs shall be taken into account in determining the amount of a service charge payable for a period—
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> (a) only to the extent that they are reasonably incurred, and
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> (b) where they are incurred on the provision of services or the carrying out of works, only if the services or works are of a reasonable standard;
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> and the amount payable shall be limited accordingly.
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> (2) Where a service charge is payable before the relevant costs are incurred, no greater amount than is reasonable is so payable, and after the relevant costs have been incurred any necessary adjustment shall be made by repayment, reduction or subsequent charges or otherwise."

23. It is accepted that section 19(1) regulates after the event expenditure. Subsection 19(2) is directed to monies which become payable before the relevant costs are incurred, the situation which arises on these facts. The appellant contends that section 19(2) envisages a two-stage process. The first is directed to the reasonableness of the amount, having regard to the relevant costs. This does not encompass consideration of the rationality of the schedule of costs nor any question of anticipated contributions from third-parties. Such contributions are said to be irrelevant when considering the reasonableness of the amount at the first stage of section 19(2), even if such sums are to be paid and it is known will be paid in the week following which the service charge becomes payable. It is a question of fact, is it a reasonable sum based upon a determination of the amount identified? It is an evaluative judgment for the tribunal.

24. The second stage, which arises after the costs have been incurred, is described as the balancing exercise. This envisages that a reconciliation of the relevant sums, so as to provide the leaseholder with the protection required pursuant to the statute. It is at this stage that credit is to be given for monies received from third-parties. Such a

construction is said to be easier to administer, monies can be recouped if there has been overpayment or credit has not been given for sums subsequently received.

25. The appellant's construction of section 19(2) is said to be consistent with the authority of *Knapper v Francis* [2017] L&TR 20 in which Martin Rodger QC (Deputy President) stated at [28] that the starting point for determination of what information can be taken into account under section 19(2) when determining a reasonable sum payable on account is the contractual position between the parties. At [38] Mr Rodger QC accepted a submission that section 19(2) allows matters not known to a landlord when its budget was set to be taken into account in determining a reasonable sum to be paid in advance. He permitted of circumstances where section 19(2) could modify the contractual obligation by reference to circumstances as they were known at the quarterly or half-yearly payment dates, but stated that he would "draw a line that the date on which the payment becomes due and would exclude from consideration matters which could not have been known at that date, because they had not occurred". It is of note that Mr Bates' submission on this point, when made before the UT, was not accepted by the Deputy President who, at [51], found that his rejection of the appellant's argument was not inconsistent with the decision in *Knapper*.

Ground two

26. The appellant accepts that it is only in the event that it succeeds in respect of ground one that ground two would fall to be determined by the court.

The second respondent

27. The second respondent contends that to place a requirement of certainty on a payment due under a guarantee or policy of insurance would be to fetter the discretion of the tribunal in determining a reasonable advanced payment in relation to service charges. The FTT correctly took account of all relevant circumstances as they existed at the date of the hearing, doing so in a broad common-sense way arriving at its conclusion giving such weight as it thought fit to the various factors in the situation: *Cumming v Danson* [1942] 2 All ER 653-655E. The appellant had indicated that it would give credit for sums received from the NHBC, the FTT was thus entitled to be satisfied that it was appropriate to take those sums into account when determining the sums reasonably payable by the respondent.

Discussion and conclusion

28. Pursuant to the terms of the lease the second respondent was contractually obliged to pay the service charge in accordance with the provisions for payment contained in clause 6 of the lease, by equal quarterly payments in advance on quarter days in each year. It is agreed that the monies due in respect of the relevant repair works would fall within the Estate Provision terms of the lease and thus would come within the ambit of clause 6.5 of the lease, namely all reasonable and proper expenditure reasonably incurred by the landlord in connection with the repair management, maintenance, improvement and other services for the estate excluding the building.

29. As was observed by the Deputy President in *Knapper* (above), the contractual position is the starting point, it is then for the court to consider the relevant statutory

provisions, in this case section 19(2) of the 1985 Act. Section 19 provides a statutory overlay to regulate the leasehold arrangements. Its effect is to modify the contractual obligation of the tenant so that no greater amount than is reasonable is payable before the relevant costs are incurred.

30. It is common ground that the appellant must give credit to the leaseholders for sums it receives from NHBC. In *Oliver v Sheffield City Council* [2017] 1 WLR 4473, the Court of Appeal held that in construing the service charge provisions in a lease, the avoidance of double recovery by the landlord was a necessary objective. There is no challenge to the finding of the FTT that the works were a reasonable approach based on reasonable investigative steps and represented a reasonable solution based upon professional advice. There is no issue as to the cost of the repair works, nor the apportionment of costs as between the respondents.

31. The sums in issue in this case are payable in advance, based on an estimate of anticipated expenditure made before any of the remedial work has been done. The UT considered a number of decisions of the tribunal and its predecessor, the Lands Tribunal, which included *Parker v Parham* [2003] EWA Lands LRX/35/2002 and *Knapper*. In my judgment the UT was correct to conclude at [51] that whether an amount is reasonable as a payment in advance is not generally to be determined by the application of rigid rules but must be assessed in the light of the specific facts of the case. A number of considerations ought or may properly have to be taken into account in determining the question of reasonableness under section 19(2) which would include the time at which the landlord would, or would be likely to, become liable for the costs, and how certain the amount of those costs is.

32. The wording of section 19(2) of the 1985 Act is intended to allow for flexibility. There is no definition as to what is reasonable nor do I find that further justification is required in order to define the word. The sense of section 19(2) is to encompass within the word "reasonable" any number of circumstances as was envisaged by the President, George Bartlett QC, in the authority of *Parker* at [23].

33. As to what is "reasonable" is for the relevant tribunal to determine, as was done by the FTT in these proceedings. It is an exercise which the tribunal is well-equipped to perform, assessing the relevant facts of each individual case and arriving at a determination based upon the evidence. The question as to whether the possibility of third-party payments can be taken into account in deciding what might reasonably be demanded on account will depend on the facts of the individual case. If certainty were to be required this would constrain the discretion of the tribunal when in reality what is required is a test which allows account to be taken of all relevant matters and to those matters will be attributed the appropriate weight. This is particularly so when the purpose of the statutory provision is to protect tenants from unreasonable demands.

34. The appellant's submission that in construing section 19(2) and determining what represents a reasonable amount, no account should be taken of a likely payment, ignores the reality of many situations. It would result in unnecessary expenditure, by leaseholders having to pay higher service charges than were reasonable, or by having to embark upon what could be lengthy proceedings in order to recoup monies which had been overcharged.

35. The imposition of rigid rules by this court, the practical effect of which would be to constrain the discretion of the tribunal in its determination of what is reasonable, is neither helpful nor cost effective.

36. For the reasons given, I accept the submission of the second respondent that in considering section 19(2) of the 1985 Act, and determining what was a reasonable amount to be paid by the respondents, the FTT was entitled to take into account all relevant circumstances as they existed at the date of the hearing, giving such weight to the various factors as it considered just and reasonable. Critical to those considerations were three facts:

    i) An effective policy of insurance was in place in respect of the repair works which would cover the majority of the works;

    ii) The appellant had agreed to give credit for any sums received from NHBC by way of insurance;

    iii) The amount of the insurance contribution was not hypothetical, the sums payable by the first and second respondents following receipt of the insurance contribution were identified to the FTT and formed the unchallenged factual basis for its determination.

37. I am satisfied that the FTT properly exercised its discretion in making the final determination which it did ([17] above). It was a determination which was upheld by the UT on grounds which are not open to challenge. It follows, and I so find, that where, as here, there exists an anticipated schedule of works, the total costs of which are reasonable and there is a possibility of a third party making a contribution to those costs, in assessing the residential service charge payable in respect of those works, the landlord does have to give credit for anticipated payment when assessing the reasonable amount to be credited on account.

38. At the conclusion of the hearing on 10 October 2019, we informed the parties that the appeal on ground one would be dismissed and that, in view of the agreement between them that on that hypothesis ground two did not arise, the appeal as a whole would be dismissed. We said that we would give our reasons in judgments to be delivered at a later date. This judgment represents my own reasons for reaching that conclusion.

Lord Justice Coulson:

39. I agree.

Lord Justice McCombe:

40. I also agree.