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LON/00BK/LSC/2007/0321

DECISION OF THE LEASEHOLD VALUATION TRIBUNAL ON APPLICATION UNDER SECTION 27A OF THE LANDLORD & TENANT ACT 1985

Address:	11 & 21 Sheldon Square, Paddington Central, London, W2
Applicant:	Sheldon Square Residents Association
Respondent:	St George North London Limited
Application:	15 August 2007
Hearing:	15-16 February 2010
Reconvene:	17 February 2010

Appearances:

Tenants

Mr D. Holland	Counsel
Mr J Little	Chairman, Sheldon Square Residents Association
Mr Blair	Treasurer, Sheldon Square Residents Association
	For the Applicant

Landlord

Mr P. Rolfe	Counsel
Ms L. Clark	Charles Russell, Solicitors
Mr R Daver	Director, Rendell & Rittner
Mr G Cunnow	Senior Customer Service Director, St George North Limited
Mr R Wade	Senior Accountant,Price Bailey, Accountants
Mr P Carolan	Accent Insurance Brokers
	For the Respondent

Members of the Tribunal

Mr I Mohabir LLB (Hons)
Mrs A. Flynn MA MRICS
Mr O Miller

IN THE LEASEHOLD VALUATION TRIBUNAL

LON/00BK/LSC/2007/0321

IN THE MATTER OF SECTION 27A OF THE LANDLORD & TENANT ACT 1985

AND IN THE MATTER OF 11 & 21 SHELDON SQUARE, PADDINGTON CENTRAL, LONDON, W2

BETWEEN:

SHELDON SQUARE RESIDENTS ASSOCIATION

Applicant

-and-

(1) ST GEORGE NORTH LONDON LIMITED
(2) PADDINGTON CENTRAL MANAGEMENT COMPANY LIMITED

Respondents

THE TRIBUNAL'S DECISION

Introduction

1. Unless stated otherwise, the page references in this Decision are to the Applicant's bundle (AB) and the First Respondent's bundle (RB) respectively.

2. This decision is supplemental to the Tribunal's earlier decision dated 13 March 2009 ("the earlier decision") and should be read together with that document. This decision is limited to those issues that were stayed at the last hearing. These are:

   (a) the application and effect, if any, of s.20B of the Landlord and Tenant Act 1985 (as amended) ("the Act") on additional service charge claimed by the Respondent in relation to the years 2004 to 2006. The

Applicant takes no s.20B point in relation to the year ended November 2007.

(b) the reasonableness of various heads of service charge expenditure claimed by the Respondent for 2006 and 2007. These are further particularised and dealt with below in the Decision.

3. Save for s.20B of the Act, it is not intended to repeat the statutory framework on which the Tribunal's determination is made, as this has already been set out in the earlier decision. Section 20B provides:

> *"(1) If any of the relevant costs taken into account in determining the amount of any service charge were incurred more than 18 months before a demand for payment of the service charge is served on the tenant, then (subject to subsection (2)), the tenant shall not be liable to pay so much of the service charge as reflects the costs so incurred.*
>
> *(2) Subsection (1) shall not apply if within the period of 18 months beginning with the date when the relevant costs in question were incurred, the tenant was notified in writing that those costs had been incurred and that he would subsequently be required under the terms of his lease to contribute to them by the payment of a service charge."*

Decision

4. The hearing in this matter took place on 15 and 16 February 2010. Both Mr Holland and Mr Rolfe of Counsel appeared again for the Applicant and the Respondent respectively. The Second Respondent did not attend and was not represented nor had it played any part in these proceedings.

Section 20B

5. The final version of the service charge accounts in relation to the actual expenditure incurred for Blocks 11, 21 and the car park in 2004 to 2007 were prepared by the Respondent on 19 May 2009 ("the final accounts"). The estimated budgets for the same years are dated 23 August 2003 and 15 December 2004 (for 2004), 15 December 2004, 1 December 2005 and 14 February 2007 respectively.

6. In relation to 2004, only the actual expenditure incurred for Block 21 exceeded the budget estimate for that year. It was conceded by the Respondent at the hearing that the excess expenditure was not recoverable by virtue of s.20B.

7. In relation to 2005, it is accepted by the Applicant that the Respondent did serve a valid s.20B notice on 30 May 2006. However, the final accounts show that the actual overall expenditure incurred for each of the blocks and the car park did not exceed the budget estimate and the Respondent has not demanded any further sum, by way of a balancing charge, for this year.

8. As to 2006, the final accounts reveal a surplus overall expenditure of £330 and £23,718 for Blocks 11 and 21 respectively. The budget estimate is dated 1 December 2005 and the Respondent served a s.20B notice on 30 May 2007.

9. Mr Holland correctly submitted that s.20B is only concerned with costs that have been incurred in any relevant year and, therefore, a landlord ought to be able to inform the tenant of the exact sum that will be charged at a future date. However, he submitted that s.20B goes further because, when considering the adequacy of a s.20B notice, one is not looking at the global expenditure incurred but at each and every item of expenditure. Consequently, where a s.20B notice fails to do so, any shortfall in expenditure on any given item may be caught by s.20B(2) if not demanded within 18 months of the cost having been incurred.

10. Mr Holland also submitted that, in the present case, the reconciliation had to be made on a block by block basis. This was accepted by the Respondent. Furthermore, Mr Holland submitted that any surplus of payments on account in any one accounting year cannot be set off against any irrecoverable excess in any preceding or subsequent year because this would amount to a "demand", as the Act limits liability to a particular year. He said that ***Gilje & Ors v Charlegrove Securities Ltd & Anor*** [2003] EWHC 1284 (Ch) was authority for the proposition that any credit by way of an overpayment cannot

prevent the time limit under s.20B from running. In addition, he contended that, having regard to paragraphs 1.1 (advance payment on account) and 1.2 (balancing charge) of the Seventh Schedule of the lease, there was no automatic assumption to be made that any overpayments are credited as payments on account. The landlord had to either credit the overpayment to the advance payment on account or against the balancing charge.

11. Adopting this approach, Mr Holland quantified, by reference to the final accounts, the excess amounts for each item of block/sector expenditure in 2005 and 2006 that exceeded the budget estimates for those years which, he submitted, was caught by s.20B. These are, helpfully, set out in Appendices 1B and 1C of his skeleton argument. He placed the figure for 2005 at £63,196 and 2006 at £53,169.

12. Mr Rolfe, for the First Respondent, submitted that costs that fell within the definition of a service charge under s.18 of the Act were recoverable provided they were not caught by the provisions of s.20 and s.20B of the Act. He said that s.20B was about a demand for payment by a landlord which a tenant had not already paid. Mr Rolfe accepted that it was a precondition to liability under paragraph 1.1 of the lease that the landlord had to serve a written demand. However, any such payments on account made did not attach to any particular item of expenditure because s.19(2) of the Act provided the requisite statutory protection for tenants where such payments are made.

13. Furthermore, Mr Rolfe submitted that the balancing charge payable under paragraph 2.2 of the Seventh Schedule was not subject to any demand served by the landlord and was not a precondition to the tenant's liability to pay. In other words, there is no contractual requirement on the part of the landlord to serve a demand and, therefore, s.20B is not engaged. In any event, the Respondent did serve s.20B notices in respect of 2005 and 2006 and was not prevented from recovering any additional expenditure incurred. Moreover, Mr Rolfe submitted that ***Gilje*** was authority for the fact that the landlord could appropriate any surplus payments to any particular item of expenditure. Where this had occurred in 2004/05, the landlord could apply the surplus as it saw fit

and this was not contingent upon serving a demand and s.20B had no application.

14. The Tribunal, firstly, considered Mr Holland's general submission that a notice served pursuant to s.20B(2) was not valid or adequate unless it specified each item of expenditure incurred by the landlord in the preceding 18 months. It did not accept that submission as being correct because this was not the intention or policy behind s.20B and cannot be inferred as he suggests. The language of the section is in general terms and refers only to "costs" incurred by a landlord. If it was intended that a notice should include the level of detail then, undoubtedly, the draftsman would have expressly set out this requirement in the legislation, as for example, are the highly prescriptive requirements imposed by s.20 of the Act.

15. In the Tribunal's judgement, the intention of policy behind s.20B(2) was that if a landlord was not able to serve a demand (if required) on a tenant within 18 months of those costs having been incurred, he must inform the tenant what his overall liability will be at some point in the future. Indeed, support for this view can be found at paragraph 27 of ***Gilje*** where Etherton, J states that the policy behind s.20B is that a *"tenant should not be faced with a bill for* (overall) *expenditure for which he or she was not sufficiently warned to set aside provision. It is not directed at preventing the lessor from recovering any expenditure on matters and to the extent of which there was adequate prior notice"*. In other words, the requirement of s.20B(2) is simply to place a tenant on notice about an overall future liability and nothing else. There is no express or implied requirement on the part of the landlord to provide the level of detail regarding the expenditure incurred as Mr Holland submitted.

16. The s.20B point is largely academic in relation to 2005 because the final accounts reveal that there was an overall surplus for that year and the notice served by the Respondent on 30 May 2006 is of no practical effect. In 2006, the final accounts showed that an overall deficit had occurred. However, it was common ground that the Respondent had served a s.20B notice on 30 May 2007 and it was not challenged by the Applicant that this notice was

invalid, other than for the reasons set out above, which have been rejected. Therefore, this deficit is, *prima facie*, recoverable by the First Respondent. Because it is recoverable, Mr Holland's submission that any amounts irrecoverable by virtue of 20B cannot be set off by applying surplus payments on account in any one accounting year also does not succeed.

17. Given that the Tribunal has found that s.20B has no application in relation to 2005 and, in particular, to 2006, it was not necessary for the Tribunal to go on to consider the submissions made by Mr Rolfe as to whether it was a precondition that any balancing charge, if appropriate, could be recovered under paragraph 2.2 of the Seventh Schedule of the lease by way a demand. The issue had now become wholly academic.

Individual Service Charge Costs - 2006 & 2007

Management Fees

18. These are the charges of Gross Fine in relation to Sectors 1, 3 and the car park and are as follows:

	2006	**2007**
11SS	19,647	20,432
21SS	18,502	19,243
CP	3,084	3,084

19. In the earlier decision, the Tribunal found that there had been a number of management failures on the part of Gross Fine and principally in relation to the preparation of the service charge accounts. The Tribunal went on to find that this was properly reflected by disallowing 40% of the management fees of Gross in 2004 and 2005.

20. It was the Applicant's case that management failures on the part of Gross Fine continued in 2006 and 2007. It relied on the evidence of Mr Little[1], the (now)

[1] see AB4/184/186/paras 24 & 25

Chairman of the Applicant Association, and Mr Holder[2], its present Secretary. The main thrust of their evidence related to the shortcomings in Gross Fine's accounting procedures which to the situation where the final accounts were not prepared until 31 May 2009. In particular, the Applicant placed reliance on the admissions made by Mr Luck, the Respondent's Finance Director, in correspondence[3] regarding the overall performance of Gross Fine as managing agents. It was submitted, therefore, the all of the management fees had not been reasonably incurred and should be disallowed in full.

21. Mr Daver, who was a Director of Gross Fine and gave evidence on behalf of the Respondent on the last occasion, was also called again to deal with the management in 2006. Both in his third witness statement[4] and in cross-examination, he maintained that the management by Gross Fine had been proactive and that the complaints made by Mr Shah (the former Chairman) and Mr Holder (in the schedule annexed to his witness statement) were actively dealt with and often resolved speedily.

22. The Tribunal also heard evidence from Mr Cunnew who is a Senior Customer Service Executive employed by the Respondent. His witness statement[5] sets out the interaction between the Applicant, Gross Fine and the Respondent's Customer Service Team. MR Cunnew's evidence dealt with the management regime in 2007. He stated that his involvement in the management increased in this year as a result of Mr Daver leaving the employment of Gross Fine in October 2006 and shortly thereafter he was followed by his assistant, Ms Sanchez, in November 2006. At paragraph 17 of his witness statement, Mr Cunnew deals with a number of specific complaints identified by Mr Holder in the schedule annexed to his witness statement. He asserted that these complaints were dealt with or progressed by Gross Fine within a short period of time. Materially, in cross-examination, he admitted that it was unacceptable for a lessee to have to personally pay £5,000 to the lift contractor to remedy a defective lift in 2007. He also accepted that the criticisms of

[2] see AB2/1-2
[3] see. AB1/275/293
[4] see AB4/190
[5] see AB4/231

Gross Fine made by Mr Fry, the Respondent's Executive Director, at paragraph 1.2 and 1.3 in a letter to Mr Shah dated 3 August 2007, were correct.

23. Having regard to the large body of documentary evidence, it was clear to the Tribunal that the management failures that occurred in 2004 and 2005 on the part of Gross Fine also continued in 2006 and 2007. This was especially so in relation to the accounting procedures employed by Gross Fine. This had, for example, led to the situation in 2007 when a lessee had to personally pay to have lift defects remedied. However, the main consequence was the delay, inaccuracies and re-amendment required in the preparation of the 2006 and 2007 final accounts. Materially, these were admitted by Mr Fry, the Respondent's Executive Director, in his letter to Mr Shah dated 3 August 2007. Indeed, at paragraph 1.3 of the letter, Mr Fry stated that the approach to work with Gross Fine to improve their performance had paid little dividends and the Respondent was considering its position as to whether any losses it had incurred as a result of Gross Fine's management should be recovered from them. The management failures on the part of Gross Fine had, undoubtedly, led to the greater involvement of the Respondent than would have otherwise been the case. Accordingly, for largely the same reasons as set out in paragraph 43 of the earlier decision, the Tribunal found that 40% the management fees of Gross Fine in 2006 had not been reasonably incurred.

24. As to 2007, it was clear that the involvement of the Respondent in the day to day management had increase because, as Mr Cunnew explained, there had been a lack of continuity on the part of Gross Fine because of the departure of Mr Daver and Ms Sanchez. It was, therefore, necessary for the Respondent to step into the breach to deal with the outstanding and ongoing complaints made by the Mr Shah and Mr Holder on behalf of the Applicant. It seems, therefore, that Gross Fine's involvement in the management had decreased. Taken together with the management failures that also continued in this year, the Tribunal found that a greater proportion of the management fees had not been reasonably incurred and determined that 50% should be disallowed.

Audit Fees

25. These are the fees of Price Bailey for auditing the accounts and are as follows:

	2006	**2007**
11SS	3,084	4,370
21SS	3,084	4,370
CP	1,175	1,700

26. The Applicant contended that the audit fees claimed were excessive because the 2006 accounts had to be prepared again, both audits were made more extensive by the accounting deficiencies of Gross Fine and that of the actual amounts were substantially higher than the budget estimates.

27. The evidence on this matter was given by Mr Luck, the Finance Director of the Respondent company. His evidence in chief and in his second witness statement[6] was that of the original accounts for year ended 30 November 2006 were prepared by Gross Fine and audited by Price Bailey. However, in the course of the audit, it was discovered that a variety of items from 2004 remained on the balance sheet unadjusted and that a number of costs had been misstated in 2005. Therefore, the 2004 and 2005 accounts had to be amended and re-issued. As a further check, the Respondent re prepared the 2006 accounts with Price Bailey's assistance at no cost to the lessees. The amendments to the 2006 account reflected the revised balance is brought forward from the amended 2005 accounts. He maintained that the amount charged for the audit fee was solely in relation to the work undertaken in 2008. Any additional costs incurred to amend the 2006 accounts were borne by the Respondent.

28. As to why the actual audit fees incurred exceeded the budget estimates for both years, Mr Luck said that these were complex service charge accounts to prepare because of the mixed tenure, the three sectors of the estate and the car

[6] see AB4/246

park. In his view, the budget estimates were too low for a development such as this given the complexities.

29. The Tribunal entirely accepted the evidence of Mr Luck on this issue. It accepted his explanation as to the reason why the 2006 accounts had to be prepared again. It accepted his evidence that any additional costs incurred in amending the 2006 accounts had been borne by the Respondent, whether or not this task had been made more extensive by the accounting failures on the part of Gross Fine. The Tribunal also accepted as evidence that the 2006 audit fee only related to the cost of repairing the original accounts in June 2008. As to the actual cost exceeding the budget estimates, the Tribunal accepted Mr Luck's evidence that the budget estimates were inadequate given the complex nature of the estate and the resultant detailed service charge accounts that had to be prepared. This was self-evident from a perusal of the accounts themselves. Accordingly, whilst the Tribunal considered the audit fees for 2006 and 2007 to be at the higher end of the scale, it found that they had been reasonably incurred and were reasonable in amount. It should be noted that the cost of preparing the trust accounts of approximately £2,000 does not form part of these costs.

Sector 1 Buildings Insurance

30. The total buildings insurance premium claimed for 2006 and 2007 were £56,658 and £56,723 respectively. Evidence as to the level of premiums charged and the commission payable in respect of this insurance is set out in the third witness statement of Mr Carolan from Ascent Insurance Brokers who was instructed by the Respondent to arrange this cover. Mr Carolan also gave evidence before the Tribunal. For the year commencing 1 October 2006, he said that the insurance premium included 25% commission of which 10% was retained by his firm and the remaining 15% was paid to the Respondent. In 2007, the commission element was reduced to 23.5% and his firm agreed to take 1.5% less commission. However, the Respondent still received a 15% share of the commission.

31. The case advanced by the Applicant was limited solely to the commission of 15% paid to the Respondent. Mr Holland made two submissions on this point. Firstly, that the commission paid to the Respondent was not a cost that had actually been incurred by it under paragraph 2 of the Seventh Schedule of the lease which defines what maintenance expenses can be recovered as relevant service charge expenditure. Secondly, that the commission represents the Respondent's administrative costs in dealing with any insurance claims and could not, therefore, be regarded as an insurance cost *per se*.

32. Mr Rolfe submitted that the commission paid to the Respondent is for arranging the insurance policy. The Applicant accepted that if a commission is not paid to the landlord then 25% is reasonable. Commission sharing is a separate arrangement with a third party and there was no difference conceptually to paying a landlord a share of the commission for doing some work on anticipated claims.

33. The Tribunal accepted Mr Holland's submissions that the insurance commission of 15% paid to the Respondent was not a cost incurred by the Respondent within the meaning of paragraph 2 of the Seventh Schedule of the lease. Therefore, it was not contractually recoverable as relevant service charge expenditure. The commission paid to the Respondent represented an element of profit and that the lease terms were only concerned with the reimbursement of the actual service charge expenditure incurred by the landlord. Indeed, the Court of Appeal in ***Jollybird Ltd & Others v Fairzone Ltd*** [1990] 2 EGLR 55 held in these terms. There is further support for this position in the earlier Tribunal decision of ***N Jiwa & Others v G & O Investments Ltd*** (BIR/OOLQ/LIS/2006/0007), which although not binding on this Tribunal, is highly persuasive. Accordingly, the Tribunal found that the insurance commission of 15% paid to the Respondent in 2006 and 2007 was not a cost incurred by it and was not recoverable as relevant service charge expenditure within the meaning of the lease. Accordingly, a 15% rebate is to be applied to the service charge accounts for 2006 and 2007 in respect of this matter.

Electricity

34. The cost for 2006 and 2007 was conceded by the Applicant as being reasonable and payable.

Costs & Fees

35. It was agreed with Counsel for both parties that these matters could be dealt with by way of written submissions once the Tribunal's decision had been handed down. The Tribunal is also mindful of the fact that permission has been granted to the Applicant by the Lands Tribunal to appeal the earlier decision. In the circumstances, the Tribunal directs both parties to file either agreed proposed directions by **4 June 2010**. In the event that directions cannot be agreed then both parties shall file their proposed directions by the same date.

Dated the 19 day of May 2010

CHAIRMAN.....

Mr I Mohabir LLB (Hons)