

Picking the wrong route to recovery – a landlord fails to recover service charges

Barrister Mark Warwick, who acted for Mott Macdonald in the case discussed in this article, describes how the courts have now ruled that landlords must strictly follow the terms of leases when recovering service charges.

An important case decided in the Court of Appeal last week (*note to eds: July 23rd 2008*) has sounded a wake up call to landlords and agents. Simply stated it means it is vitally important they fully follow the language of leases in order to recover service charges. Failure to do so led to landlord Leonora Investment losing a claim for £263,117 plus costs because it did not follow the prescribed procedure.

The decision in *Leonara Investment Co Ltd v Mott Macdonald Ltd* [2008] EWCA civ 857 is vital because it concerned a set of leases whose provisions as to service charges were structured in a familiar way. The brief facts were as follows. Leonora was the landlord of a 13-storey office block in Croydon. In July 2000 it demised four floors of that building, by four separate but very similar leases, to engineering consultancy Mott MacDonald. The leases provided for the payment of a Service Charge defined as “the sum payable by the Tenant in accordance with Part 2 of the SCHEDULE OF SERVICES hereto”.

The first three paragraphs of the Schedule of Services were the key ones when considering liability. Paragraph 1 decreed that the Service Charge was to be “such fair proportion ... of the actual or anticipated Service Cost for each Service Charge Year which shall be assessed by the Landlord or its surveyor according to a reasonable and proper basis for apportionment applicable from time to time to the Premises”.

Paragraph 2 decreed that the Landlord might send to the Tenant a notice including the Landlord’s estimate of the “anticipated Service Costs” and if so the Tenant would pay one-quarter of this estimate on the usual quarter days. The language of paragraph 3 was the focus of legal argument. It stated as follows:

“The Landlord will (unless prevented by causes beyond its control) prepare and send to the Tenant a statement of actual Service Costs and Service Charge for each Service Charge Year as soon as practicable after the end of such year and in the event of the Service Charge for the Premises exceeding the aggregate amount paid by the Tenant for such year the Tenant will pay the balance due to the Landlord within 14 days of demand and in the event of the aggregate amount being greater the excess will be credited by the Landlord by way of a set-off against the next instalment of Service Charge due from the Tenant ...”.

For the first two years of the Lease the Landlord sought quarterly advance payments for Service Charges, which were paid. In the first two years, 2000 and 2001, the Landlord also provided statements in accordance with paragraph 3 and the Tenant paid the balance due.

Between about May and September 2002 the Landlord carried out significant works to the 4 floors of the office block that were occupied by Mott MacDonald. The Landlord’s agent took the view that the cost of these works “were regarded as extra and outside the “normal” Service Costs” and in a witness statement he stated “we also intended to invoice for them separately”. So these costs did not feature in the demands for quarterly, on account, service charges.

On 15th January 2003 the Landlord wrote to the Tenant referring to the refurbishment of the common parts. A breakdown of these costs was provided, together with an invoice for a lump sum of £263,117. The Tenant never paid this invoice and there followed desultory correspondence, over several years. Eventually the Landlord sued upon the invoice and a preliminary issue was directed, relating to whether the Tenant had any liability to the landlord pursuant to the terms of the Lease in respect of the sum claimed in the invoice.

At the trial of the preliminary issue the Landlord stressed that the monies claimed in the invoice were indeed Service Charges and it would be wrong for the Tenant to avoid liability because of the method chosen to demand them. Particular reliance was placed upon the earlier Court of Appeal decision in *Universities Superannuation Scheme Ltd v. Marks & Spencer plc* [1999] 1 EGLR 13 . In that case Marks & Spencer was a tenant of premises at the Telford Town Shopping Centre. The structure of its lease required the landlord to provide an annual certificate showing the amount

of the service charge. The certificate contained a summary of the landlord's expenses and then a calculation of the proportion of those expenses due from the tenant. This proportion involved a comparison of the rateable value of the tenant's premises to the rateable value of the whole shopping centre. The landlord provided a certificate and the tenant paid the amount claimed. However, subsequently, the landlord discovered that it had wrongly calculated the tenant's proportion. The trial judge dismissed the landlord's claim for the balance of the service charges due. The Court of Appeal reversed this decision. They said that the certificate was not conclusive. The tenant had to pay the sum due in accordance with the provisions of the lease. These provisions referred to a set percentage based on rateable values. Since it was accepted that the landlord's original calculation or rateable values was erroneous, and since there was no question of estoppel, the tenant had to pay the extra sum claimed.

It is noteworthy that in the *USS* case there was an error in the original certificate. The position in *Leonora* was different. There was no error. The Landlord never sought to reopen any of its earlier demands. It sought to pursue a demand made in a different way. Having lost at first instance, *Leonora* appealed. Although the *USS* case featured in its written argument before the Court of Appeal, that case was not relied upon by the Landlord in oral argument. Instead a new, and subtle, argument was developed. This contended that the statement referred to in the first part of paragraph 3 was only concerned with a situation where the Landlord had made a demand for the monies on account, pursuant to paragraph 2. If there were Service Charges which had not been included in the preceding year's estimate, then these Service Charges fell outside the Service Charge structure and could be demanded in a different way. Since there was no express machinery for recovery of these Service Charges they were simply repayable on demand.

The Court of Appeal rejected the Landlord's revised way of putting its case. The principal judgment was delivered by Tuckey LJ. Having examined the machinery for the recovery of Service Charges in the Leases, he was not satisfied that there was any lacuna. Any end of year demand had to involve Service Costs that featured in the statement that the Landlord served upon the Tenant pursuant to paragraph 3. Tuckey LJ, at paragraph 17, said:

The simple question: what does the Lease say has to happen before the Tenant is obliged to pay Service Charge?”

Having examined paragraphs 1 to 3 of the Schedule dealing with Service Charges, he said:

“They prescribe the contractual route down which the Landlord must travel to be entitled to payment”.

Since the Landlord had not travelled down that contractual route it lost.

The plain and obvious lesson arising from *Leonora* for all landlords is: follow the language of the Lease. Do not attempt to be creative. If you seek to do so, the result may be a disaster. *Leonora* picked the wrong contractual route. The route did not lead to a destination marked “recovery”. Instead it arrived at a destination marked “failure”.

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