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FIRST-TIER TRIBUNAL
PROPERTY CHAMBER (RESIDENTIAL PROPERTY)

Case Reference	:	**LON/00BK/OLR/2015/0202,0408,0409,0410, 0411,0412,0422,0425,0427,0474**
Address	:	**Various flats at Dorset House, Gloucester Place, NW1 5AB**
Applicants	:	**The 78 Leaseholders of flats at Dorset House**
Representative	:	**Mr Paul Letman instructed by Coleman Coyle solicitors**
Respondent	:	**Redwing Asset Holdings Limited**
Representative	:	**Mr Anthony Radevsky instructed by Summers Solicitors**
Type of Application	:	**Grant of new lease (Section 48 Leasehold Reform, Housing and Urban Development Act 1993)**
Tribunal Members	:	**Mr M Martynski (Tribunal Judge)** **Mr N Martindale FRICS**
Date and venue of Hearing	:	**8 & 9 March 2016** **10 Alfred Place, London WC1E 7LR**
Date of Decision	:	**22 March 2016**

DECISION

Decision summary

1. The Service Charge terms of the new leases will remain unchanged.

2. We record the agreement between the parties that the sum to be paid for the registration of assignments, transfers etc. will be £30 in the new leases.

Background

3. The subject flats are contained within a large building ('the Building') which comprises approximately 198 residential flats and substantial commercial units on the ground floor.

4. The Respondent holds the freehold interest in the Building. Dorset House Residential Limited has a head lease of the residential parts of the Building. Dorset House's predecessor in title was a company called Bellnorth, that company went into liquidation in 2010.

5. We were provided with a sample residential lease (flat 4). It is dated 26 August 1975 and is for a term of 125 years less ten days from 24 June 1975.

6. We were also provided with a sample Notice and sample Counter-Notice. The Notice claiming a new lease is dated 11 April 2014. The Counter-Notice is dated 20 August 2014. The Counter-Notice admitted the right to a new lease but sought a replacement of the existing Service Charge covenant in the lease.

7. Directions on the applications were given on 13 March, 20 May and 7 October 2015.

8. The final hearing took place on 8 & 9 March 2016. By the time of that hearing all valuation issues had been agreed and there were only two matters in dispute, those being; first, the sum to be paid for registrations of assignments, transfers etc. – that issue was resolved immediately prior to the commencement of the hearing with agreement that the relevant sum would be £30.00 plus VAT.

9. Second, whether the existing Service Charge clause should be replaced in part with a new clause. It was only this second issue that was argued at the hearing.

The Service Charge clauses

10. The relevant parts of the existing Service Charge clause in the leases are as follows (as per the lease for flat 4);

> 3. THE Lessee for himself and his assigns to the intent that the obligations may continue throughout the term hereby created hereby COVENANTS with the Lessor as follows that is to say:-
>
> .....
>
> (2) (a) To pay and contribute to the Lessor a proportionate part.....in the sum of .5549 per cent of:-
>
> (i) the cost of insuring.....
>
> (ii) the water rate.....

(iii) the cost of maintaining repairing redecorating and renewing;-
(a) the structure of the building.....

.....

.....

(xii) such sums as the Lessor shall reasonably consider necessary from time to time to put to reserve to meet the future liability of carrying out major works to the Building or the Flat with the object so far as possible of ensuring that the contribution shall not fluctuate substantially in amount from time to time

.....

(b) The amount of such contribution shall be ascertained and certified by the Lessor's Managing Agents (whose certificate shall be conclusive final and binding on both parties hereto) once a year in respect of the year to Twenty-ninth September preceding the date of the certificate as soon as reasonably practicable at any time after the Twenty-ninth day of September in each year.....The Lessee shall .....on the Twenty-fifth day of March and the Twenty-ninth day of September in each year pay a sum equal to one half of the amount payable by the Lessee for the preceding year under the provisions of this Clause on account of such contribution and shall on demand pay the balance (if any) ascertained and certified as aforesaid PROVIDED THAT until the contribution shall have been ascertained and certified as aforesaid for the year ended Twenty-ninth September One thousand nine hundred and seventy-five the Lessee shall on each of the said half yearly days fixed for payment of rent as aforesaid pay the sum of TWO HUNDRED AND TWENTY POUNDS 96 (£221.96) (sic) on account thereof

11. The clause proposed by the Respondent to replace the existing provision is as follows:-

2(2)(a) to pay and contribute to the lessor ("the contribution") in the sum of [ ] %

2(2)(b) The lessee shall pay the contribution to the Lessor (including any sums to be placed in reserve for extraordinary expenditure) in advance in four equal instalments on 25th March, 24th June, 29th September and 25th December in every year throughout the term of the lease in an amount reasonably estimated and notified to the Lessee from time to time by the Lessor's managing agents or the Lessor's [sic] and an Account of the total expenditure in relation to the provision of services for the Building for the period ending 31st December and for each subsequent year ending on 31st December during the term of the lease shall be prepared and as soon as practicable thereafter provided to the Lessee together with a note of the balancing payment of the contribution to be made by the Lessee, with credit given for the payments made in the relevant year and certified as correct by the Lessor's accountants or managing agents ("the Certificate") and within 21 days after the service of the Certificate for the period in question the Lessee shall pay to the Lessor the balance by which the Lessee's payments made in accordance with sub-clause (b) fall short of the contribution as certified for such period and any overpayment by the Lessee shall be credited against future payments due from the Lessee or at the end of the term of the lease shall be refunded to the Lessee.

12. In summary therefore, the existing lease clause provides for the landlord to certify the expenditure for the year to 29 September and then for the leaseholder to make the contribution to that expenditure by two instalments on 25 March 29 September. Accordingly therefore, not only is the leaseholder paying in arrears, the leaseholder is paying those arrears in two instalments; the first instalment due six months

after the (service charge) year end, the second due 12 months after the (service charge) year end.

13. The proposed replacement clause provides for quarterly payments of Service Charge contribution on account by the leaseholder during the Service Charge year in question and for there to be a balancing payment (if applicable) after the (Service Charge) year end.

14. The existing arrangement in respect of Service Charges is therefore one of payment in arrears, the proposed clause is for payment in advance.

The Respondent's case in summary

15. Before summarising the evidence given to us, it is necessary, in order to put that evidence into context, to summarise the Respondent's case for a replacement of the Service Charge clause- we summarise as follows;
    - There have been a number of relevant changes;
        - in conveyancing practice
        - in legislation
        - in the actual operation of the service charge in the Building
        - in that a number of other leaseholders have agreed to vary the Service Charge clause in the lease

      since the leases in question were drafted which affect the suitability of the existing service charge regime - s.56(6)(b) Leasehold Reform, Housing and Urban Development Act 1993 ('the 1993 Act').
    - The existing lease term as to Service Charges is defective – s.56(6)(a) of the 1993 Act.
    - The tribunal should, in accordance with s.57(2) of the 1993 Act replace the Service Charge clause given that it has a wide discretion so to do.

The evidence

16. We summarise the evidence given to us (in the form of a witness statement and oral evidence from each witness) as follows.

Martin Desmond Codd (Expert for Respondent)

17. Mr Codd is a Solicitor with extensive experience of the drafting of leases for large residential blocks and of advising in respect of the landlord and tenant issues that arise in such blocks.

18. He states in his report; "*In my experience, payment of service charge in arrears is an extremely unusual way of collecting monies...*". His report goes on to comment upon the Service Charge clause in the leases in question as follows;

> I have always thought that such provisions were drafted in this way to provide the tenants with some degree of security knowing that the landlord would not demand an unreasonable amount at the outset and then either not

> spend it or misappropriate the funds. By paying after the event the tenants can see what the landlord has done and if sub-standard not pay. [para 4.5]
>
> In my view, such drafting as found in the leases granted on this building is no longer necessary and indeed never in my entire career have I ever been instructed by any client to draft a lease with payment of service charge in arrears. [para 4.6]
>
> In my view, the Landlord and Tenant Act 1985 and the amendments made by later legislation so as to limit the amount of service charge which can be demanded in advance by way of reasonableness and confirm that all monies so collected are held under a statutory trust are a fundamental change in the law since the Leases on the Building were granted. [para 5.8]

19. Mr Codd then refers to the Council of Mortgage Lenders Handbook and the Law Society Conveyancing Protocol. Both of these require a purchaser's solicitor to check that the provisions in a lease for insurance, repair and maintenance are adequate. He states that neither of these guides existed at the time of the grant of the leases in question.

20. Mr Codd continues in his report;

> On the face of it, although the existing lease does contain wording dealing with these items, if following an enquiry with the Buildings Managing Agents, it became apparent that in practice that the actual arrangements for administering the service charge fund were found wanting then a conveyancer would be concerned and would want to know if the lender's surveyors were aware of the problem before issuing their valuation. [para 6.4]

21. Mr Codd refers to the standard Law Society's Conveyancing Handbook and its advice that; '*A landlord's solicitor may wish to consider providing for an estimate of the service [charge] be payable in advance and for there to be a reconciliation at the end of the year*'.

22. As to the consequences of the existing clause, Mr Codd states that they are '*neither good for the landlord nor for the leaseholders*'.

23. In his oral evidence to the tribunal Mr Codd confirmed that, whilst under the present clause the landlord would invariably face a cash flow problem on the routine Service Charges, he was not suggesting in his report that the landlord could not operate a reserve fund.

24. He added that if one of the leases in question came to him, he'd probably report it to the lender and say that it affected the value of the property.

Mr Eric Frank Shapiro (for Respondent)

25. Mr Shapiro is a Chartered Surveyor and has considerable expertise in valuation and property management.

26. In his witness statement, Mr Shapiro pointed out that under the current Service Charge clause, in all likelihood the landlord will

constantly have to operate on the basis that his full costs as they are being expended are not being covered by Service Charges and that the landlord is not able to recover the costs of borrowing from leaseholders if he chooses to cover the shortfall in that way.

27. Mr Shapiro concludes in his statement that;
    - the annual costs of the Building are substantial
    - the managing agent has no assets against which to borrow on a shortfall of service charges
    - In a block of this kind major capital expenditure will be required over the years and it may not be the case that there is sufficient money in the reserve fund to cover that expenditure in any one year
    - The Service Charge scheme as currently drafted is disadvantageous to all the lessees.

28. In oral evidence Mr Shapiro agreed that in the 1970's, as is the case today, it was more usual to collect Service Charges in advance. Mr Shapiro further agreed that in the 1970's and in many years since that time, inflation rates have been very much higher than we have become accustomed to in recent times. He did not believe that the lease term in question was any more suitable now, in a time of low inflation, as it was when first drafted in a time of high inflation. He accepted that major works could be funded by the creation of and contribution to a reserve fund and that this could be done under the current lease clause; however, the terms of collection of contributions to reserve under the current Service Charge clause would make this more difficult.

Mr Soloman Unsdorfer (for Respondent)

29. Mr Unsdorfer is a Managing Agent and has been managing the Building since 2000.

30. In his witness statement, Mr Unsdorfer said that when his firm took over management of the Building, there had been a lack of planned maintenance and capital funding due to; '*the deficiencies of an exceptionally defective lease*'. He went on to refer to the relevant lease terms and said; '*In such a precarious situation it is understandable why a landlord will be reluctant to embark on major works without the certainty of funds being available to pay contractors on due dates. This is what brought Dorset House to its state of advanced dilapidation in 2000*'. Mr Unsdorfer then goes on to give some brief detail of major works that he arranged for the Building including some pipework replacement.

31. According to Mr Unsdorfer's statement, at the end of the pipework replacement in 2009, tenants owed almost two million pounds in arrears, the statement continued;

> Without a modern lease allowing the funding of legal costs to recover these arrears and compounded by the inability to budget for the new additional costs in advance, Bellnorth (the Respondent's predecessor in title) found itself in severe cash flow difficulties.....Bellnorth went into liquidation at the end of 2010.

32. Mr Unsdorfer referred to various decisions of the Leasehold Valuation Tribunal regarding the Building and comments made by those tribunals as to problems with the Service Charge term. He concluded, referring to the Bellnorth liquidation; *'It is easy to foresee the same collapse happening again and again until the lease terms are updated'.*

33. In his oral evidence Mr Unsdorfer confirmed that the lessor was not able to re-charge the cost of borrowing to fund Service Charge shortfalls and that accordingly, as leaseholders only had to pay Service Charges in arrear, the lease was defective. In order to get works done, contractors were asked to work by way of contractor finance. Mr Unsdorfer suggested that the current landlord was interested in maintaining the Building given the substantial commercial leasehold interests at ground floor level.

34. As to current Service Charge arrears, Mr Unsdorfer put these at £502,000.

Mr Robert Henry Stuart (Expert for Applicant)

35. Mr Stuart is a Solicitor and has many years conveyancing experience. In his report, he says;

> By the PROVISO to clause 2(2)(b) of the Specimen Lease the draftsman made provision for payment by way of a higher rent from the commencement of the lease until the service charge contribution in arrears shall have been ascertained. In my opinion the draftsman of the Specimen Lease made provision for the landlord to be in funds during the first year of the lease. [para 3.8]
> In my opinion whilst service charges are payable in arrears with payments pegged to the previous year's contribution, the effect of the PROVISO to clause 2(2)(b) and Clause 2(2)(xii) together provide a workable service charge mechanism. The costs of future major works are to be funded by inclusion in the service charge of such sums as the landlord shall reasonably consider necessary from time to time to put to reserve to meet those future liabilities for major works to the Building and/or the Flat [para 3.9]

36. Mr Stuart goes on to refer to leases he has identified dated 1969, 1976 and 1984. All those leases provided for payments on account. He states that, in his experience of looking at leases from the 1960's, 1970's and 1980's, Service Charge obligations for most leases have remained, in substance, similar.

37. Mr Stuart adds that he did not consider that there was any evidence that the draftsman of the leases in question in these proceedings was influenced by the relevant legislation at the time (that is, section 90 Housing and Finance Act 1972) nor that the amendments made by

subsequent legislation have changed the substance of Service Charge provisions in leases.

38. As to changes in conveyancing practice over the decades, whilst he agreed that there had been developments in conveyancing guidance, he referred to the fact that many of the flats in the Building have mortgages and that 32 of those mortgages appear to post-date the first edition of the Council of Mortgage Lenders Handbook. He concludes therefore that it was likely that, in the face of the CML guidance, the conveyancers have found the leases in the Building to be compliant with that guidance. Mr Stuart concludes that CML is an '*encouragement to best practice*' and that the other guidance, the Conveyancing Quality Scheme, is a 'kitemark' for best practice but that neither amount to a fundamental or material change in practice.

39. Mr Stuart considered the Service Charge provisions in the leases in question to have been as uncommon when they were drafted as they are now.

40. In his oral evidence to the tribunal, Mr Stuart said that in his experience one can still come across an unusual form of lease from time to time and that since the date of his report for these proceedings, he had come across a lease from 2010 with a clause that provided for Service Charges to be paid in arrears – he had not however brought a copy of that lease with him to the hearing. He added that he still sees leases that he does not consider to be CML compliant and this includes leases on new developments.

Mr Nicholas Hopewell-Smith (for Applicant)

41. Mr Smith is a leaseholder in the Building. In his witness statement he commented that, as far as he was concerned, the Building was not in a poor state of repair when he bought his flat in February 2001. His view was that, because the lease allowed for contributions to a reserve to be demanded, so far as major works were concerned, there was no difficulty in managing the Building, it just needed proper planning. He referred to previous litigation in the Leasehold Valuation Tribunal (more on which later in this decision) and alleged that poor management was the cause of many difficulties in the Building, not the wording of the leases.

42. Mr Smith went on to refer to the transfer of the head leasehold interest from Bellnorth to the Respondent in December 2010 shortly after which time Bellnorth went into liquidation. He states that the leaseholders have obtained leave to apply to set the transfer of the head leasehold interest aside on the basis that the transfer was at a gross undervalue (£25,000).

43. An issue that was referred to by Mr Unsdorfer in his evidence was also referred to by Mr Smith, that is the issue of the special fund that had previously been set up for the collection of Service Charges. Mr

Unsdorfer had said that this special fund had been set up to get round the difficulties caused by the Service Charge provisions in the leases. According to Mr Smith, this fund was created as a commercial compromise and as an interim measure to keep the Building running following the outcome of litigation in the Leasehold Valuation Tribunal.

44. In his oral evidence to the tribunal, Mr Smith said that he had no personal objection to the payment of Service Charges in advance but that other leaseholders took a different view.

Previous litigation and decisions of the Leasehold Valuation Tribunal

Bellnorth v Leaseholders – April 2005

45. In its decision in these proceedings, the tribunal referred to major works being carried out in the 1990's. Referring to those works the decision continues as follows:-

> Those works were the subject of an application to the tribunal ..... that application was heard over a period of 12 days between October 1998 and July 1999. It was common ground that during the course of that hearing the then managing agents agreed a total reserve contribution, with the residents association, of £500,000 pounds per annum. That sum was demanded and apparently paid in 1998, 1999 and 2000. At that point the previous managing agents were replaced by Parkgate-Aspen Limited. For reasons best known to themselves they demanded no reserve fund contribution in 2001 whilst in 2002 they demanded a reserve fund contribution of £350,000. [para 4]
>
> The applicants now propose to replace the hot and cold water supply pipes and the soil and rainwater pipes and connect the water supply to the mains..... The total cost of the project was estimated at just over £6 million..... [para 5]
>
> The applicant applied under section 27A of the Act for a determination of the reserve fund contributions that would be payable by the Lessees, as part of the service charge, for the current and future years. [para 10]

The tribunal set out the relevant clauses of the lease and went on as follows;

> However, in this case the on account payments are calculated by reference to the service charge payable in respect of the preceding year. As Mr Brown pointed out the final account for any service charge year is not generally completed and issued until some months after the end of the service charge year. Thus the on account payments cannot be ascertained until some months into the service charge year. Furthermore, given the way in which the on account payments are ascertained, the reserve fund contribution can only be assessed annually when the annual accounts are prepared and the managing agents certificate issued. [para 12]
>
> These provisions posed a problem for the applicant in that it was effectively required to fund the service charge expenditure for the first six months of any service charge year save to the extent that the reserve fund could legitimately be used for that purpose. The applicant had circumvented the adverse cash flow consequences of these provisions in two ways. Firstly it

> had demanded the first on account payments on the last day of the preceding service charge year and the second on account payments on 25 March in the service charge year. It had calculated the first on account payments by reference to the pre–preceding year accounts and had to then treated the second on account payments as a balancing charge so that both on account payments equalled the amount of the preceding years account. Secondly it had set a reserve fund contribution in each year and had then demanded it by two equal instalments on the days upon which it had demanded on account payments: that is 29th September and 25th March. The lease does not provide for payment of the reserve fund contribution in this way. [para 13]
>
> Although we fully appreciated the adverse cash flow implications of the service charge provisions of the Lease, the Applicant' remedy was not to impose an alternative scheme of its own design but to seek a variation of the lease terms either by agreement or under the provisions of the Landlord and Tenant Act 1987. [para 14]
>
> We considered that the Lease permitted the lessor to reassess the reserve fund contribution at reasonable intervals as both the extent and costs of future major works became apparent. The publication of Mr Fullick's estimate, in November of last year, provided such an opportunity. It was reasonable to take account of that estimate by increasing the reserve fund contribution. If it were not so increased then the service charge contributions would fluctuate over the next few years as the contractor's bills were discharged and included in the annual service charge accounts..... Furthermore sub-clause 2(2)(a)(xii) of the Lease placed a responsibility, if not a legal obligation on the Applicant to maintain a sufficient reserve to avoid undue fluctuations in the service charge: A responsibility that has not been fulfilled. [para 30]

The tribunal went on to conclude that the leaseholders would be liable to pay a Service Charge for reserve fund contributions of various amounts for various specified years and made an order preventing the landlord from recovering the costs of the proceedings before the LVT from the leaseholders.

Dorset House Residential Limited v The leaseholders – July 2012

46. This tribunal dealt with two applications. The first from the landlord to determine the liability of leaseholders to pay Service Charges for 2009, 10 & 11. The second was the leaseholders' application for the appointment of a Manager.

47. It became apparent during the first hearing before that tribunal that the proposed Manager was not suitable. At the adjourned hearing, the leaseholders decided not to proceed with their application for the appointment of a manager following undertakings given by the landlord.

48. The main decision of the tribunal concerned major works carried out the Building by a company known as 'Argent'. Those works became complicated and disputed mainly due to an unforeseen planning issue and the discovery of asbestos in the Building. Argent was left being owed a great deal of money.

49. After noting the relevant lease terms, the tribunal commented:-

An effect of these provisions is that, other than by way of reserve fund contributions, it is difficult for the landlord to collect in advance the money required for major works. That is a particular problem because the infrastructure of the block has required massive expenditure in recent years.

50. At paragraphs 58 and 59 of the decision, the tribunal noted as follows:-

> It is clear to us from the evidence that there were several factors in the decision which Philip Wallis took to allow Bellnorth to go into liquidation without paying Argent.
>
> One was that many, although not all, the tenants had refused to pay their service charges. ..... It is sufficient to say that we are satisfied that a large number of tenants failed to pay their service charges, resulting in massive arrears, and we are satisfied that that was a very significant factor in Mr Wallis's decision to allow Bellnorth to go into liquidation. It is relevant, however, to observe that those who controlled Winllan (Dorset) Ltd and Nome Ltd, two companies in the same group as Bellnorth, which owned, between them, some 17 flats in the block, had also decided not to pay their service charges until, at the hearing of the application to appoint a manager,.....

51. The tribunal continued from paragraph 60 of the decision onwards:-

> Another factor which led to the liquidation was that a tribunal [in 2010] had disallowed a large part of the fee which Bellnorth had paid to VBS under a qualifying Long term agreements for providing services in relation to the PRP because Bellnorth had failed to consult the tenants in relation to it. The tribunal also disallowed other service charges for lesser amounts because it considered that they were not recoverable under the lease. Taken together, we understand that the effect of the tribunal's previous decision was that some £1,000,000 of costs incurred by Bellnorth were declared by the tribunal to be irrecoverable from the tenants.
>
> In our view a majority of the tenants, and Bellnorth, are, broadly speaking, equally to blame for the liquidation. That is not to say, however, that the costs which have flowed from the liquidation are payable as a service charge. In our view those costs ..... are too remote from the costs of the works which are recoverable under the lease. [para 62]

The relevant law

52. The relevant provisions of the Leasehold Reform, Housing and Urban Development Act 1993 ('the Act') are as follows:

> **57 Terms on which new lease is to be granted.**
> (1) .....
> (2) Where during the continuance of the new lease the landlord will be under any obligation for the provision of services, or for repairs, maintenance or insurance—
> (a) the new lease may require payments to be made by the tenant (whether as rent or otherwise) in consideration of those matters or in respect of the cost thereof to the landlord; and
> (b) if the terms of the existing lease do not include any provision for the making of any such payments by the tenant or include provision only for the payment of a fixed amount) the terms of the new lease shall make, as from the term date of the existing lease, such provision as may be just—
> (i) for the making by the tenant of payments related to the cost from time

to time to the landlord, and
(ii) for the tenant's liability to make those payments to be enforceable by distress, re-entry or otherwise in like manner as if it were a liability for payment of rent.

(3) Subject to subsection (4), provision shall be made by the terms of the new lease or by an agreement collateral thereto for the continuance, with any suitable adaptations, of any agreement collateral to the existing lease.

(4) For the purposes of subsections (1) and (3) there shall be excluded from the new lease any term of the existing lease or of any agreement collateral thereto in so far as that term—

(a) provides for or relates to the renewal of the lease,

(b) confers any option to purchase or right of pre-emption in relation to the flat demised by the existing lease, or

(c) provides for the termination of the existing lease before its term date otherwise than in the event of a breach of its terms;

and there shall be made in the terms of the new lease or any agreement collateral thereto such modifications as may be required or appropriate to take account of the exclusion of any such term.

(5) Where the new lease is granted after the term date of the existing lease, then on the grant of the new lease there shall be payable by the tenant to the landlord, as an addition to the rent payable under the existing lease, any amount by which, for the period since the term date or the relevant date (whichever is the later), the sums payable to the landlord in respect of the flat (after making any necessary apportionment) for the matters referred to in subsection (2) fall short in total of the sums that would have been payable for such matters under the new lease if it had been granted on that date; and section 56(3)(a) shall apply accordingly.

(6) Subsections (1) to (5) shall have effect subject to any agreement between the landlord and tenant as to the terms of the new lease or any agreement collateral thereto; and either of them may require that for the purposes of the new lease any term of the existing lease shall be excluded or modified in so far as—

(a) it is necessary to do so in order to remedy a defect in the existing lease; or

(b) it would be unreasonable in the circumstances to include, or include without modification, the term in question in view of changes occurring since the date of commencement of the existing lease which affect the suitability on the relevant date of the provisions of that lease.

The parties' submissions

Respondent

53. *Section 57(2)(a)*: This sub-section, argued Mr Radevsky (Counsel for the Respondent) gave the tribunal a wide power to include new terms in a lease where there is an obligation on the part of the landlord to provide services or where it is responsible for repairs. The word 'may' in this sub-section is critical and it is that word that gives the discretion.

54. If therefore the tribunal has the discretion to replace the existing Service Charges clauses with new ones, then, given that the current clauses are problematic and unusual, a new more workable and usual clause can, and should, be inserted.

55. Mr Radevsky relied on *Gordon v Church Commissioners* (LRA/110/2006), a decision of HHJ Huskinson in the Lands Tribunal dated 25 May 2007. This case concerned a proposal by the tenant to

insert into a new lease being granted under this part of the Act a clause whereby the landlord would be required to enforce covenants on other lessees under the terms of their leases. The LVT concluded that the clause should not be included in the new lease.

56. The questions for the Lands Tribunal were; (a) did the LVT have the power to insert the clause?, if so; (b) should the new clause be added?

57. The tenant argued that section 57(6) of the Act was sufficiently wide to allow new provisions not in the existing lease.

58. The tribunal dismissed the appeal but in so doing stated, in passing:-

> Similarly under section 57(2), where this applies, provisions dealing with certain topics are to be included being such provisions "as may be just". Again this gives a notably wider power to the LVT and the Lands Tribunal to decide upon the new terms than under section 57(6). [para 40]

59. *Section 57(6)(a)*: This sub-section only comes into play where there is a defect in the lease that requires amendment. Mr Radevsky did not seek to argue that the leases were defective at their outset but argued that they had become so. He relied upon the evidence given by Mr Unsdorfer as to the difficulties in managing the Building and in the comments of the previous tribunals that have encountered this building (as previously recorded in this decision).

60. We were referred to *Rossman v The Crown Estate Commissioners* [2015] UKUT 0288 (LC), a decision of the President. The case concerned the grant of a new lease under the Act. In this case, when the block in question was developed in the 1960's and 70's and flats sold on long leases, the aggregate Service Charge contribution from leaseholders amounted to 100% of expenditure. However, the block was, after the time of the grant of the original leases, further developed with the result that the aggregate contribution from leaseholders exceeded 100%. The lease in question was one of those originally created. Originally therefore the Service Charge provisions in the lease were not defective, however they became so after the further development of the building and the granting of new leases for additional flats.

61. The point here relied upon by Mr Radevsky was that section 57(6)(a) came into play, not only where the lease as originally drafted was defective, but also where the lease had become, in a material aspect, defective.

62. *Section 57(6)(b)*: Mr Radevsky relied on there having been four changes that had occurred since the date of the grant of the leases in the Building affecting the current suitability of the of the provisions in the lease.

63. The first of these changes is practice in the field of conveyancing. Mr Radevsky argued that, according to the evidence given to the tribunal, no one in the modern era would draft a lease with similar 'in advance' Service Charge clauses. If a solicitor did not comply with the relevant guidance, he or she might, according to Mr Stuart's evidence in cross-examination, be liable to a claim in negligence.

64. Mr Radevsky brought our attention to the limited statutory provisions in force at the time of the drafting of the leases. Section 91A of the Housing Finance Act 1972 introduced (by amendment in 1974) a very limited concept of reasonableness in respect of Service Charges. That section provided that a Service Charge was only recoverable; (a) in respect of the provision of chargeable items to a reasonable standard; and (b) to the extent that the liability incurred or amount defrayed by the landlord in respect of the provision of such items is reasonable.

65. On 22 November 1979, the Chancery Division in *Frobisher (Second Investments) Ltd. v Kiloran Trust Co. Ltd. and another* [1 WLR 425] held that the effect of section 91A was that landlords could not demand sums from tenants in advance of Service Charge expenditure in maintaining the property in question. The Court also held that the landlord could not charge the costs of financing Service Charge payments in arrear if there were no specific right to do so reserved in a lease.

66. This decision, it would appear, came as something of a surprise. The government of the day acted swiftly to correct the situation. We were provided with extracts from Hansard where the decision in *Frobisher* and its effect was considered. The extract contains the following observation by Lord Bellwin on the issue;

> First of all, it has been common practice for leases of flats to provide for some part of a service charge to be paid on an interim basis.....
>
> A second practice, which is not as general as interim payments but is certainly not uncommon, is for a lease to require contributions to a sinking fund for major repairs..... Neither this government nor, as I understand it, any previous Government..... have taken the view that interim payments or contributions to sinking funds should be entirely banned..... Nevertheless, the High Court in the very recent case of Frobisher v. Kiloran took the view that the provisions made about service charges by the Housing Act 1974 were so worded as to make a requirement for advance payments in that case not lawfully enforceable.
>
> It was not the intention in 1974 to ban advance payments.

67. Mr Radevsky wondered if the draughtsman of the leases in question had the foresight to see the point raised in *Frobisher*. If he did, then the lease was drafted in the way it was so as to avoid falling foul of section 91A and payments in advance. After the effect decision in Frobisher had been reversed by legislation, there was a change in conveyancing practice so as to provide for payments on account.

68. The second relevant change since the date of the commencement of the leases in question is the various changes in legislation over the years. The object and effect of those changes have been for the protection of leaseholders paying a Service Charge. Given those changes, the leaseholder no longer needed to be protected by only having to pay Service Charges in arrear (if that was the purpose behind the way in which the Service clauses were drafted).

69. The third change is that, according to Mr Radevsky, '*the operation of the payment in arrears system operated in Dorset House over the years has proved to be disastrous, causing litigation and insolvency.*'

70. The final change relied upon is the fact that a number of leaseholders, in extending their leases, whether by the statutory route or by negotiation, have, in their new leases, agreed to Service Charge provisions that allow for payments on account.

Applicants

71. *Section 57(2)(a)*: Mr Letman, Counsel for the Applicants, argued that this sub-section cannot be taken as a general power to alter Service Charge provisions for the following reasons.

72. First, as to *Gordon,* the Judge's comments that section 57 contains a wide power to vary terms appear to be in relation to subsection (b), not (a). In paragraph 40 of the judgment (quoted above) the reference to the words 'as may be just' shows that the reference is to subsection (b), not (a), as these words appear in subsection (b).

73. Second, the wording of section 57 appears to have been taken directly from the 1967 Leasehold Reform Act at s.15(3). The relevant parts of section 15 provide as follows:-

> (2) The new tenancy shall provide that as from the original term date the rent payable for the house and premises shall be a rent ascertained or to be ascertained as follows:—
> (a) the rent shall be a ground rent in the sense that it shall represent the letting value of the site (without including anything for the value of buildings on the site) for the uses to which the house and premises have been put since the commencement of the existing tenancy, other than uses which by the terms of the new tenancy are not permitted or are permitted only with the landlord's consent;
> (b) the letting value for this purpose shall be in the first instance the letting value at the date from which the rent based on it is to commence, but as from the expiration of twenty-five years from the original term date the letting value at the expiration of those twenty-five years shall be substituted, if the landlord so requires, and a revised rent become payable accordingly;
> (c) the letting value at either of the times mentioned shall be determined not earlier than twelve months before that time (the reasonable cost of obtaining a valuation for the purpose being borne by the tenant), and there shall be no revision of the rent as provided by paragraph (b) above unless in the last of the twenty-five years there mentioned the landlord gives the tenant written notice claiming a revision.

> (3) Where during the continuance of the new tenancy the landlord will be under any obligation for the provision of services, or for repairs, maintenance or insurance, the rent payable in accordance with subsection (2) above shall be in addition to any sums payable (whether as rent or otherwise) in consideration of those matters or in respect of the cost thereof to the landlord; and if the terms of the existing tenancy include no provision for the making of any such payments by the tenant, or provision only for the payment of a fixed amount, the terms of the new tenancy shall make, as from the time when rent becomes payable in accordance with subsection (2) above, such provision as may be just for the making by the tenant of payments related to the cost from time to time to the landlord, and for the tenant's liability to make those payments to be enforceable by distress, re-entry or otherwise in like manner as the liability for the rent.

The wording of sub-section (2) appears to have been taken without regard to the sense that it makes in the 1993 Act as between paragraphs (a) and (b) of s.57(2) or other sub-sections. In the 1967 Act, what sub-section (3) is getting at is clear from sub-section (2), it makes sense in those terms, but not in the terms of the 1993 Act. In the 1967 Act, sub-section (3) is there to make it clear that a Service Charge will be payable in addition to a rent.

74. Third, section 57(2)(a) only makes sense if it is a limited power to alter the Service Charge provisions of a lease if the landlord has an obligation to provide those services and there is no or limited corresponding obligations on the part of the leaseholder to contribute to the cost of them.

75. Fourth, if sub-section (2) gave such a wide power, then this would circumvent the restricted circumstances set out in sub-section (6) in which a lease term can be excluded or modified.

76. *Section 57(6)(a)*: There is no identifiable defect in the lease. The starting point is that the new lease is a lease on the same terms. Mr Letman drew our attention to *Burchell v Raj Properties Ltd*, a decision of the Deputy President of the Upper Tribunal [2013] UKUT 0443 (LC). That case deals with s.57(6)(a). The lease term in question [clause 2(16)] was a covenant on the part of the lessee to use the flat as a private dwelling for the lessee and his family and for no other purpose. At paragraph 43 of his judgment the Deputy President remarks as follows on the question of the alleged defect in the lease in that case:-

> I do not think it is possible to regard clause 2(16) as a "defect" in the sense of a mistake which neither party can have intended to be included in the Lease as originally granted. I incline strongly to the view that the covenant was included deliberately. It is possible that its consequences may not have been appreciated by the original Lessee, although for the reasons I have given in para 31 above, it is equally possible that both parties would have seen benefits for themselves in the covenant.

77. As for the case of *Rossman* relied upon by the Respondent, this case does not distinguish other authorities, it simply has very different facts and is confined to those very particular facts where a very clear and

distinct defect arose in the lease over time by the addition of further flats in the building.

78. The fact that disputes have arisen between the parties was not sufficient to establish a defect in the lease. In any event, there were a range of reasons why the parties were in dispute, there was no evidence that the Service Charge clauses in the lease was the main cause of those disputes.

79. Mr Unsdorfer, the Managing Agent, identified the alleged defects in the lease in his witness statement at paragraphs 7 & 10. He makes reference to the difficulty, under the terms of the leases, in budgeting for major works. However he ignores the fact that the lease provides for payments to a reserve fund. The way in which the lease works in this regard may not suit the way that he likes to run his business but it is not a defect in the lease. Further, the new clause proposed by the Respondent changes the way in which leaseholders are to pay to Service Charges (in advance as opposed to in arrears) but leaves the provision to pay towards a reserve fund in place. What then does the new lease term change if the defect is the planning for major works?

80. Finally on this point, there is no evidence that the leases, in their current form, have affected the mortgageabilty of the flats.

81. *Section 57(6)(b)*: As to the changes since the lease was granted set out by the Respondent, Mr Letman argued as follows.

82. There is no evidence that there has been a change in conveyancing practice since the leases in question were drafted; the leases are simply unusual, both in their time and now.

83. As to the suggestion that the draughtsman of the leases had *Frobisher* in mind, the extract from Hansard showed that no-one had expected the meaning of the law as it stood at the time of drafting to be that a landlord could not validly demand payments on account.

84. As to the change in legislation, the legislation applies equally to the current lease form as they do to the proposed lease clause.

85. As to the fact that other leaseholders have accepted the new lease term, this was not relied upon in any of the expert evidence. In any event, it is the lessor who has made this change.

86. So far as the guidance that is now available and in force as to drafting and examination of leases, that guidance is 'high level'. The obligations upon conveyancers is only to check that a lease has a reasonable provision for Service Charges. The guidance to draughtspersons is only that they 'may' wish to provide for payments on account.

Decision

87. We are of the view that there are no grounds on which the Service Charge provisions in the leases as currently drafted can be changed as argued for by the Respondent.

88. Dealing with the points as raised by each party and set out above, we comment as follows.

Section 57(2)(a)

89. We do not agree with the Respondent's submission that this sub-section confers on us the wide power to modify the clause in question. There are a number of difficulties in such an interpretation of this sub-section. Hague (Sixth Edition – 32.07) states as follows:-

> The drafting of these service charge provisions is not entirely happy. The first provision [that is s.57(2)(a)] appears to give a general discretion to impose a service charge whenever the new lease imposes an obligation to provide services, or carry out repairs etc. and regardless of the terms of the existing lease. If that is so, it is difficult to see the need for the second provision [s.57(2)(b)].

The footnote to this section confirms that these provisions appear to be based on section 15(3) of the 1967 Act as pointed out by Mr Letman for the Applicants.

90. In our view, the only sense that can be put on sub-paragraphs (a) & (b) is that they are making it clear that a Service Charge is payable as or in addition to a rent and that there is a power to impose a Service Charge in the absence of one in the old lease. They do not appear to be giving power to amend an existing and workable Service Charge clause. This is especially so given the restricted circumstances in which a lease term can be excluded or modified in section 57(6).

91. We agree with Mr Letman's suggestion that the Judge in *Gordon* is most likely referring to sub-paragraph (b) when he talked about a 'wider power' in paragraph 40 of his judgment.

Section 57(6)(a)

92. It cannot be said that there was a defect in the lease as originally granted. The term is quite clear and workable. The draughtsman clearly had in mind the contributions to Service Charges going forwards from the outset because included in the lease is a provision that, pending the certification of the Service Charge for the year ending in September 1975, the leaseholder is to pay sums on account.

93. As to the Service Charge becoming defective over time, we do not consider that there is any clear evidence that this has been the case. The tribunal decisions that we were referred to clearly show that there have been disputes but these disputes have concerned other matters. There

have been references in these decisions to the fact that Service Charges are payable in arrears and that this creates challenges in management but the subject matter of these cases is not the 'in arrears' issue.

94. The 2005 LVT decision concerned the amounts to be collected for reserves and noted that a problem was that the obligation on the part of the landlord to maintain a sufficient reserve had not been fulfilled.

95. A decision of the LVT made in 2010 restricted the sums claimable from leaseholders by way of Service Charges due to the landlord's failure to follow the statutory consultation procedure.

96. The LVT decision from 2012 concerned problems arising out of major works and the amounts due to a contractor.

97. There is nothing in these decisions that suggest that the main issues and problems dealt with by the tribunals arose directly out of the payment in arrear provisions of the Service Charge.

98. Mr Unsdorfer and Mr Shaprio in their evidence clearly explained the practical difficulties that the payment in arrears clause caused in terms of management for the landlord but they were unclear as to how those difficulties made the management of the Building impossible or how (in the case of Mr Unsdorfer's evidence) the reserve fund clause makes the planning of major works impossibly or unreasonably difficult. It seemed to us, that with proper planning, there is no difficulty in operating a workable reserve fund to pay for major works. In any event, as pointed out by Mr Letman, in terms of the reserve fund, there is little difference between the new clause proposed by the Respondent to the existing one.

99. There was no clear example in Mr Unsdorfer's evidence to show that the 'in arrears' clause was unworkable. Mr Shapiro's evidence on this point was only to show, in theory, what problems may arise.

100. We note that no application has been made over the years to vary the Service Charge clause pursuant under the provisions of the Landlord and Tenant Act 1987.

Section 57(6)(b)

101. We are not convinced that there has been any relevant and clear change in conveyancing practice since the leases were drafted. First, it is clear that the leases were unusual at the time, as unusual as they are today. Second, we do not consider that the 'high level' guidance that now applies to conveyancing practice (and which was not in force at the time of the drafting of the leases) makes any clear difference to drafting. The guidance is only to make sure that there is a workable Service Charge clause and to 'consider', when drafting a lease, the inclusion of a provision for payments on account. Third, there is no evidence that the Service Charge clause has caused any issues with the value or

mortgageability of the leases. As to Mr Codd's evidence that, if he were acting for a purchaser with a mortgage, he would report concerns about the lease to the lender because it may affect the value of the property – there is no evidence that values are affected or that disputes have arisen solely due to the existing Service Charge lease provisions – Mr Codd if asked to explain his concerns would have little, if any, hard evidence to provide on the issue or risk or mortgageabilty to the lender.

102. The suggestion that the draughtsman of the subject leases had anticipated the *Frobisher* decision is simply too far fetched and there is no evidence for this contention. There is no evidence that leases generally provided for payments in arrears prior to *Frobisher* and that they generally provided for payments on account once the decision in *Frobisher* had been dealt with in subsequent legislation.

103. As to the general changes in legislation to the benefit of leaseholders since the leases were drafted – again there is no evidence that this has affected the way in which Service Charge terms have been drafted. Again, we reject the contention that the draughtsman can be said to have been acting for the protection of leaseholders when drafting the leases with payments in arrears especially as it seemed that most people at the time thought that the legislative protection at the time applied to payments in advance and most leases at that time provided for payments on account.

104. We have above already dealt with the fact that there is little evidence that the lease term has caused disputes. As to the collapse of Bellnorth, according to the Creditors' report, the causes of the collapse were the non-payment (not necessarily *late* payment) of Service Charges by leaseholders; the LVT decision that Bellnorth had not followed the statutory consultation procedure in respect of major works leaving it owing £933,000 and, an award of £76,700 (following an employment claim) to a former employee – nothing here about cash flow problems caused by the wording of the leases.

105. We have some doubt that these disputes and the collapse of Bellnorth are in any event relevant 'changes' within the meaning of s.57(6)(b). We agree with Mr Letman that these were 'events' rather than 'changes'.

106. We reject the contention that the fact that other leaseholders have agreed to changes in the lease terms are or should be relevant changes within the meaning of s.57(6)(b). These events have been brought about solely by the actions of the landlord. We were told that these changes have been, or are to be made to approximately 29 leases. Taking into consideration the 78 leases involved in these proceedings, that would still leave a significant amount of leases with old lease terms in any event.

Mark Martynski, Tribunal Judge
22 March 2016