

UPPER TRIBUNAL (LANDS CHAMBER)



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TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

LANDLORD AND TENANT – SERVICE CHARGES – combined block heating and hot water system replaced with modern system – whether cost recoverable as cost of providing a service – whether irrecoverable as cost of improvement rather than repair – appeal allowed

IN THE MATTER OF AN APPEAL AGAINST A DECISION OF THE FIRST TIER
TRIBUNAL (PROPERTY CHAMBER)

BETWEEN: LONDON BOROUGH OF SOUTHWARK

Appellant

and

MICHELLE BAHARIER

Respondent

Re: 37 Gilesmead,
79 Camberwell Church Street,
London SE5 7LN

Martin Rodger QC, Deputy Chamber President and P D McCrea FRICS

The Royal Courts of Justice

9 January 2019

Philip Rainey QC, instructed by London Borough of Southwark Legal Services, for the appellant

Justin Bates and *Rayan Imam*, instructed by Commonhold and Leasehold Experts Ltd, Solicitors all acting *pro bono*, for the respondent

The following cases are referred to in this decision:

Braganza v BP Shipping Ltd [2015] UKSC 17

London Borough of Hounslow v Waaler [2017] EWCA Civ 45

Plough Investments Ltd v Manchester CC [1989] 1 EGLR 244

Yorkbrook v Batten (1986) 52 P&CR 51 (CA)

Introduction

1. This appeal is about liability for the estimated cost of replacing a worn-out central heating and hot water system serving a block of flats in Southwark. The total anticipated cost of the work was almost £800,000 but the amount in issue in the appeal is £24,486.88. That is the contribution which the appellant landlord, the London Borough of Southwark, sought to recover in February 2015 as an advance service charge from the respondent Ms Michelle Baharier, the owner of the long lease of one of the flats in the block.
2. We will refer to the appellant as “the Landlord” and to Ms. Baharier as “the Tenant”.
3. On 16 August 2017 the First-tier Tribunal (Property Chamber) (“the FTT”) decided that the Tenant was not obliged to make any contribution towards the estimated cost of installing a new heating and hot water system which had by then been installed in her flat. The reason for that decision was that the FTT considered that the work carried out by the Landlord was an “improvement” rather than a “repair” of the original system, and that the terms of the Tenant’s lease obliging her to pay a service charge did not require her to contribute towards the cost of improvements.
4. The appeal is brought with the permission of this Tribunal, permission having been refused by the FTT. At the hearing of the appeal the Landlord was represented by Philip Rainey QC and the Tenant by Justin Bates and Rayan Imam. We are grateful to all counsel for their assistance, but particularly to Mr Bates and Ms Imam both of whom acted *pro bono* in the appeal, not having appeared before the FTT.
5. As Mr Bates pointed out, while in legal terms this appeal is about the construction of a lease, in human terms it is another example of the serious problems that can befall tenants of modest financial means who, having exercised their statutory right to buy their homes are later faced with very large service charge bills when their local authority landlord carries out major works projects to the building. Many local authorities, including Southwark, offer assistance to their former secure tenants in meeting these bills, including extended interest free payment terms.

The facts

6. The Tenant is the long lessee of 37 Gilesmead, 79 Camberwell Church Street, London SE5, which is one of 40 units in a low-rise block of flats and maisonettes owned by the Landlord. Having originally been a secure tenant of the Landlord she acquired her current interest in 2008 when she exercised her right to buy under Part 5, Housing Act 1985.
7. Gilesmead was built in 1968. As built, it was served by a communal heating and hot water system. Two gas fired boilers located in a communal boiler house adjacent to the building provided both heating and hot water to each flat.

8. For the purpose of heating, hot water was pumped to each flat through communal pipework. Within the flat the hot water passed through a single “heat battery” located in the main living space (in effect a large radiator), across which a thermostat-controlled fan circulated air, warming the open plan living room and kitchen-dining area and, in theory, the remainder of the flat. To keep the whole of the flat warm required the door to each room to be left open.

9. The original hot water system comprised two communal storage cylinders, from which hot water was pumped to each flat via secondary pipes following the same route as those for the heating system. Each flat drew hot water from the central cylinders, rather than a cylinder of its own.

10. It is not in dispute that the original heating and hot water system at Gilesmead did not comply with modern standards. The Tenant described it in 2012 as extremely expensive and completely ineffective, and she told the FTT that she had to supplement the system by using electric heaters. It is likely to have been designed to satisfy the “Parker Morris” standards which were recommended to local authorities by the Ministry of Housing in 1963 and became mandatory for all council housing in 1969. The 1961 report of the Parker Morris Committee was principally concerned with space standards in public housing but it also recommended that new dwellings should be fitted with heating systems which maintained kitchen and circulation space at 13 degrees Celsius, with living and dining space at 18 degrees.

11. Options for replacing the original system had been under consideration for many years before a decision was taken to provide a new communal system. The possibility of installing individual boilers in each flat was ruled out as not technically feasible because the building’s extensive fenestration did not allow space for individual flues; the Landlord appears also to have considered that in the case of the two thirds of the flats held on long leases it was required by the terms of those leases to provide a communal heating service.

12. Under the new system, the flats are kept warm by radiators in each room, each of which can be operated independently. The water in the radiator system is now in a secondary circuit, heated by passing through a thermal store (a large cylinder), containing a heat exchanger. The water in the heat exchanger coil is heated by communal boilers in the boiler house and then distributed round the building. Cold water also passes through the thermal store under mains pressure, providing hot water to each flat; as a supplement or backup to this arrangement an immersion element in the thermal store can also heat water for both the taps and the radiator.

13. The design features common to both the original and the replacement systems are the communal boilers in the boiler house, and the provision of space heating and hot water by means of hot water circulating from the boiler house. In neither system is there an independent source of heat in any individual flat.

14. The main respects in which the two systems differ are that under the new system each room can be heated independently, and the heating system is a closed individual circuit; the hot water is now drawn from the mains before being heated by the heat exchanger in each flat, rather than being heated centrally and then pumped hot around the building.

The Lease

15. The lease of Flat 37 was granted on 21 April 2008 for a term of 125 years. At clauses 4(2) to 4(4) it contains the usual Landlord's covenants to repair the structure and exterior of the flat and the building. By clause 4(5) the Landlord also covenanted:

“To provide the services more particularly hereinbefore set out under the definition of “services” to or for the flat and to ensure so far as practicable that they are maintained at a reasonable level and to keep in repair any installation connected with the provision of those services”

The definition of the services previously set out referred to “the services provided by the Council to or in respect of the flat and other flats and premises in the building and on the estate and more particularly set out hereunder- (i) Central heating (ii) hot water supply...”

16. The cost of providing the services is recoverable from the Tenant who covenants by clause 2(3)(a) to pay the service charge contribution provided for in the Third Schedule.

17. For this appeal the relevant parts of the Third Schedule are in paragraphs 6 and 7. By paragraph 6(1) the service charge payable by the Tenant is to be a fair proportion of the costs and expenses set out in paragraph 7 incurred in the year to which the charge relates. Those costs and expenses include the following:

“7. ... the costs and expenses of or incidental to

(1) the carrying out of all works required by sub-clause (2) to (4) inclusive of Clause 4 of this lease

(2) Providing the services hereinbefore defined.

...

(6) The maintenance and management of the building

...

(9) The installation (by way of improvement) of

(i) double glazed windows (including associated frames and sills) in replacement of any or all of the existing windows of the flat and of the other flats and premises in the building and in common areas of the building; and,

(ii) an entry phone system...

should the Council in its absolute discretion (and without being under any obligation) decide to install the same or either of them”

The FTT's decision

18. The sum in issue before the FTT was claimed as an interim service charge, calculated by reference to estimates prepared before the final costs of the project were known. Neither party had legal representation at the hearing; the Tenant was unrepresented and the Landlord sent an employee from its service charge enforcement department. It was natural in those

circumstances that, after reading the parties' statements of case, the FTT should direct them to the legal issues which it considered significant.

19. In her own statement of case, which she had prepared with the assistance of the CAB, the Tenant argued that she did not have to pay for improvements to the heating and hot water system; she also took a number of other points which are not the subject of this appeal. The Landlord's statement of case had been professionally prepared and relied on its obligation in clause 4(5) of the lease to provide the services. It pointed out that the services specifically included central heating and hot water, and referred to paragraph 7(2) of the Third Schedule which included the cost and expenses of providing the services as one component of the Service Charge.

20. In paragraphs 16 and 17 of its decision the FTT referred to the relevant provisions of the lease and recorded that there had been a consensus at the hearing on what the important issue was:

“The Tribunal expressed the preliminary view (whilst making it clear that it was open to being persuaded otherwise) that the service charge provisions of the lease allow the landlord to levy a service charge in respect of ‘repairs’ to the district central heating system but not in respect of ‘improvements’ to the district central heating system. Both parties in fact agreed that this was the case.”

Having accepted this formulation of the issue the Landlord's representative then argued that the replacement of the system was work of repair. After summarising the detailed evidence about the design of the new and old systems, and having directed itself on the distinction between a repair and an improvement by reference to leading textbooks, The FTT reached its main conclusions in paragraphs 37 and 38, as follows:

“37. It is a question of fact and degree whether work amounts to “repair” or “improvement”. In the present case, a background heating system and communal hot water system, with background heat provided only from a single source in the living area, has been replaced with a full central heating system with radiators in every room and a thermal store which provides heating and hot water to each individual dwelling, and which contains an immersion element which can potentially heat the water.

38. The tribunal notes that “repairs” can involve an element of improvement. However, having heard detailed evidence, the Tribunal considers that the system which has been substituted by the landlord for the original communal district heating system is “different in kind” from the system which was originally in place. The tribunal finds on the facts of this case that the work amounts to “improvement” rather than “repair”. Accordingly, the sum claimed by the landlord in respect of the work is not payable pursuant to the terms of the tenant's lease.”

21. The Tenant had also raised a number of other defences to the service charge, none of which succeeded. The FTT concluded at paragraph 49 of its decision that, if the cost of the work had been payable under the Lease, it would have been satisfied that the interim service charge was reasonable. We take that way of expressing the FTT's conclusion as indicating

that it was satisfied that there was no other contractual or statutory obstacle to the Landlord's entitlement to recover the Tenant's full contribution towards the estimated expenditure.

The issues in the appeal

22. On behalf of the Landlord Mr Rainey submitted that the FTT had reached the wrong conclusion in law for two reasons: first because the relevant covenant was a covenant to provide services, to which the distinction between repair and improvement was irrelevant and the implicit limit on the ambit of "repair" was inapplicable; and secondly because in any event the FTT's approach to its evaluation of the differences between the original and replacement systems was flawed and its conclusion that nothing was payable because the work went beyond repair was not a conclusion which the FTT could properly have reached. Even if the repair/improvement distinction was of relevance, most of the design principles of the two systems were identical and the work simply involved replacing new for old; the conclusion that no part of the cost was recoverable was therefore irrational.

23. For the Tenant Mr Bates realistically acknowledged the force of the Landlord's first ground of appeal and, without conceding the point, he devoted most of his submissions to a skilful attempt to avoid the consequences. He pointed out that the landlord's representative at the hearing before the FTT had agreed that the critical question was whether the work was a repair or an improvement. The Landlord now wanted to run a fundamentally different case on appeal, which it ought not to be permitted to do. Even if the FTT's identification of the issue had been flawed, the best that the Landlord could achieve on the appeal was a decision remitting the matter for reconsideration because there were other issues which needed to be considered before an assessment of the Tenant's liability could be arrived at. In particular, it had to be considered whether the decision to install the new communal system at much greater expense than individual alternatives was a rational one (applying the principles limiting the exercise of a contractual discretion identified by the Supreme Court in *Braganza v BP Shipping Ltd* [2015] UKSC 17, which were confirmed also to constrain the recoverability of contractual service charges by the Court of Appeal in *London Borough of Hounslow v Waaler* [2017] EWCA Civ 45).

Issue 1: Should the Landlord be permitted to advance a new case on appeal?

24. Mr Bates' first response to the Landlord's main ground of appeal was that the Tribunal should not allow it to be argued, because even if it succeeded it did not mean that the FTT's decision had been wrong. The FTT had addressed the issue which the parties had agreed was the main issue, namely whether the work was a repair or an improvement. It could not be said to have been wrong, and its decision upset, simply because the Landlord had now found a more compelling way to put its case.

25. There are a number of reasons why we do not accept this submission. The Tribunal does not encourage a technical approach to the identification of the issues which are properly raised by an appeal. Parties are often permitted to raise new points, provided it can be done without unfairness or inconvenience to other parties or to the Tribunal. The relevance of the

repair/improvement distinction to clause 4(5) of the lease is a matter of law which does not depend on the facts of the case.

26. In any event, Mr Bates cannot suggest that the argument which the Landlord now wishes to run is a new argument. It is exactly the point it pleaded in its statement of case before the FTT, where it referred in several places to its own obligation to provide a heating and hot water service, and the Tenant's obligation to contribute towards the cost of doing so.

27. Mr Bates can legitimately say that the Landlord's representative at the hearing before the FTT agreed with the tribunal when it suggested that the service charge provisions of the lease allow the Landlord to levy a service charge in respect of repairs but not improvements. We do not consider that makes any difference to the Landlord's entitlement to put its case in a different way on appeal if it can do so on the basis of the factual material presented at the original hearing. Parties should not be discouraged from appearing before the FTT without the assistance or expense of lawyers by the threat that if they concur in the tribunal's own identification of a legal issue they will be bound by it thereafter even if the FTT expressed the issue too narrowly (as Mr Bates acknowledged it had done in this case).

Issue 2: Was the cost of the new system recoverable as the cost of providing a service?

28. The Landlord's covenant at clause 4(5) of the lease obliges it to provide the services, amongst which are space heating and hot water, and to ensure so far as practicable that these are maintained at a reasonable level. By paragraphs 6 and 7(2) of the Third Schedule the Tenant is liable to pay all costs and expenses of or incidental to providing the services.

29. A covenant to provide services is not the same as a covenant to repair; it imposes a wider and potentially more onerous obligation. As the authors of *Dowding & Reynolds on Dilapidations* say at paragraph 13-17 of their book, such a covenant "may require the covenantor to carry out whatever work is necessary to provide the service, even though that work goes beyond what would ordinarily be called repair".

30. As a matter of contract, it is for the Landlord to decide how to supply the central heating/hot water service. That principle is firmly established in the case of covenants to repair (Lewison LJ included it as one of the uncontroversial propositions in paragraph 14 of his judgment in *Hounslow v Waaler* citing *Plough Investments Ltd v Manchester CC* [1989] 1 EGLR 244 in support). It applies equally to covenant to provide a service. In *Yorkbrook v Batten* (1986) 52 P&CR 51 (CA) at pp.61-62, the Court of Appeal applied the principle to a covenant very similar to clause 4(5) of the lease in this case:

"The [landlords]' covenant was, and is, to provide "a good sufficient and constant supply of hot water and an adequate supply of heating in the hot water radiators." How they achieved this was a matter for them."

31. Because a covenant to provide a service of heating and hot water imposes an obligation to take whatever steps are required to achieve an outcome it is not relevant to consider in any

detail what those steps are. The distinction between repairs and improvements, and the question of whether a particular programme or item of work goes beyond repair, is therefore irrelevant.

32. Mr Bates did not seek to argue against any of those propositions. He acknowledged that clause 4(5) was not simply a covenant to repair the original system but he nevertheless submitted that the Tenant is under no obligation to pay for anything which goes beyond a repair. The covenant was in two parts, with the second part obliging the Landlord to keep the installations in connection with the provision of the services in repair. If the first part was to have the unrestricted effect argued for by Mr Rainey, the second part would have no effect. The parties must be taken to have intended something by the inclusion of the second limb, and Mr Bates submitted that they intended to limit the scope of the covenant to provide services.

33. The draftsman had obviously been aware of the difficulties that can be caused by the distinction between repair and improvement, and had made express provision for certain improvements in Schedule 3, which referred at paragraph 7(9) to “the installation (by way of improvement) of ... double glazed windows ... and an entry phone system.” The failure to make similar provision in clause 4(5) for improvements to the services was telling, Mr Bates suggested. The reference to maintenance and repair in the second limb of the covenant should be taken to demonstrate that the Landlord’s duty is a limited one, and is concerned only with keeping what is present working, rather than with replacing it with something new. If the landlord chose to go beyond maintaining or repairing the original installations it would do so at its own cost. It was not suggested that the original system could not have been replicated, and the evidence of the landlord’s technical witnesses was that it would have been possible to replace it with something similar.

34. We do not accept Mr Bates submissions on this point. It is true that clause 4(5) also obliges the Landlord “to keep in repair any installation connected with the provision of those services”, but if the repair of those installations is insufficient to maintain the service at a reasonable level the covenant as a whole clearly obliged the Landlord to take additional steps to satisfy its primary obligation of providing the service. It is the service which is to be maintained, not the installations by which it is provided.

35. In any event, it is unrealistic to suggest that the parties entering into the lease intended the building to remain unchanged throughout the term. When the lease was granted in 2008 the heating and hot water installations were already almost 40 years old and unable to provide a reasonable level of heating. The lease was for a term of 125 years and the only sensible expectation would have been that the existing installations would be replaced in their entirety in the relatively short term, and would probably be replaced again during the remainder of the term. In that context the parties cannot have intended that the Landlord’s only obligation should be to repair what was present or replace it with something satisfying modern requirements at its own expense. Nothing in the lease suggests that there was intended to be any potential for a gap to exist between the Landlord’s obligation to provide services and the Tenant’s obligation to pay for them. It would be most unusual for a lease to entitle the Landlord to recover the cost of providing only part of the cost of a service, and had that been intended it would have been spelled out in the clearest possible language.

36. We are therefore satisfied that the FTT directed itself and the parties by reference to the wrong question. It ought not to have asked whether the costs of the replacement system were costs of repair or costs of improvement, but rather whether they were costs and expenses of or incidental to providing the services of heating and hot water, or of ensuring so far as practicable that those services were maintained at a reasonable level.

37. In view of the conclusion we have reached on the first two issues it is not necessary for us to consider whether the FTT was right to find that the work was work of improvement rather than repair. That is a distinction of no significance to the parties' contractual rights in this case.

Issue 4: Can the Tribunal make a determination of liability at this stage?

38. Although the FTT said specifically at paragraph 49 of its decision that, if the cost of the work had been payable under the Lease, it would have been satisfied that the interim service charge was reasonable, and although it dismissed all of the Tenant's other challenges to her liability, Mr Bates submitted that the issue of the payability of the service charge should be remitted to the FTT for further consideration. On the basis that a landlord had a discretion how it chose to deliver a service it must nevertheless demonstrate that its decision to do so in a particular way was a rational one. That requires consideration of the circumstances of individual tenants and the Landlord's decision-making process which had not yet taken place.

39. Mr Bates was also concerned, if the matter was not remitted, to preserve the opportunity for the Tenant to argue additional points, including the rationality of the decision to install a new communal system, which had not been argued at the first hearing.

40. We are satisfied that there is no need to remit the appeal to the FTT and that we can safely substitute a determination that the Tenant is liable to pay the whole of the sum of £24,486.88 claimed by the Landlord on 19 February 2015 as her contribution towards the estimated costs of the renewal of the heating and hot water services.

41. The points raised by the Tenant in her case before the FTT, and which it listed at the start of its decision, included whether the sum charged was reasonable in amount. It was satisfied that it was (and there was no evidence that the same work could have been done for a lesser sum). The FTT did not consider the Landlord's decision-making process in any detail (except to find that the statutory consultation requirements had been complied with). A considerable body of written evidence and relevant documents was available at the hearing which demonstrated what that process had been. That material included a feasibility study undertaken in 2012 by external consultants which explained the project in some detail, including the reasons why it was considered impractical to install individual central heating boilers in each flat, and the relative cost over the life of the new system of different approaches. It would have been open to the Tenant to argue that the decision to incur the cost of the works was irrational but she did not do so. She would have required considerably more evidence of her own to counter the Landlord's evidence that her preferred alternative approach was not viable.

42. The final account for the work should be available by now, and when it is presented it will be open to the Tenant to dispute her liability to pay, or to require reimbursement of any overpayment. In particular she will be able to raise concerns she expressed to the FTT that the new heating system is not of a reasonable standard, which was a matter specifically left over by the FTT for consideration at the final account stage. If she wishes at that stage to raise an irrationality argument and supports it with expert evidence she may be met with the response that she ought to have argued that point on the first occasion. We express no view on that question, but we do not consider that there is any material before us which would justify remitting the matter to the FTT to enable such any additional challenge to be made to the estimated charge.

Disposal

43. We therefore allow the appeal and substitute the determination in paragraph 40 above. We heard no submissions on any application under section 20C, Landlord and Tenant Act 1985, or on the consequences of a successful appeal on the section 20C order made by the FTT in respect of the costs of the proceedings before it. If either party wishes to make any further submissions on those matters they may do so within 28 days of the date of this decision.

Martin Rodger QC
Deputy Chamber President

Peter D McCrea FRICS
Member

5 March 2019