FIRST-TIER TRIBUNAL
PROPERTY CHAMBER
(RESIDENTIAL PROPERTY)

Case reference	**:**	**LON/00BG/LVM/2021/0005**
Property	**:**	**Canary Riverside Estate, Westferry Circus, London E14 (the "Estate")**
Applicant	**:**	**Sol Unsdorfer, tribunal appointed manager**
Applicant's Representative	**:**	**Wallace LLP**
Respondent	**:**	**(1) Octagon Overseas Limited** **(2) Riverside CREM 3 Limited** **(3) Canary Riverside Estate Management Limited** **(4) Circus Apartments Limited** **(5)Leaseholders represented by the Residents Association of Canary Riverside**
Respondents' Representative	**:**	**(1) - (3) Ince Gordon Dadds LLP** **(4) Norton Rose Fulbright LLP** **(5) Residents' Association of Canary Riverside**
Type of application	**:**	**Variation of order for appointment of a manager**
Tribunal Judge	**:**	**Judge Amran Vance**
HMCTS Code	**:**	**V: CVPREMOTE**
Date of decision	**:**	**28 April 2021**

DECISION

Covid-19 pandemic: description of hearing

This has been a remote video hearing which has not been objected to by the parties. A face-to-face hearing was not held because it was not practicable and all issues could be determined at a remote hearing. The documents to which we were referred were included in a digital hearing bundle provided by the Applicants. Numbers in bold and in square brackets below refer to pages in that bundle.

DECISION

1. I am satisfied that the tribunal has jurisdiction to vary the current Management Order to order that the First to Third Respondents pay to the Manager shortfalls in sums due to him, from leaseholders on the Estate, by way of service charge, including the costs of provision of shared services.
2. In all the circumstances of this case, I consider it proportionate, just, and convenient to vary the Management Order to insert a new paragraph 4(o) as follows:

   "The Manager is entitled to recover from Virgin Active Health Clubs Limited's immediate landlord (Riverside CREM 3 Limited) any outstanding service charges owed by that company to the Manager, now or in future, such sum to be paid by the immediate landlord within 21 days of a Demand identifying:

   (a) the total sum claimed;

   (b) the manner in which the sum is calculated;

   (c) the relevant lease provisions; and

   (d) copies of demands served.

BACKGROUND

3. This is an application, received on 8 April 2021, made by the tribunal-appointed Manager of the Canary Riverside Estate ("the Estate"), Mr Unsdorfer, under s.24(4) and/or 24(9) Landlord and Tenant Act ("the 1987 Act") and under paragraph 18 c) of the current Management Order, last varied on 12 April 2019 (the "MO"). In his application the Manager sought:

   (a) confirmation that the MO as currently drafted provides suitable provision for the recovery of any bad debts; or

   (b) if it does not, an amendment to the MO to enable such provision.

4. The Estate is a large mixed residential and commercial site comprising 325 flats within four residential blocks, as well as a hotel, a gym, restaurants and an underground car park.
5. The First Respondent is the Freehold owner of the Estate. The Second and Third Respondents are long leaseholders of parts of the Estate. The

Fourth Respondent is a long leaseholder of parts of Eaton House, 38 Westferry Circus. The Fifth Respondent comprises those leaseholders represented by the Residents Association of Canary Riverside.

6. What has prompted the application is an anticipated shortfall in income following, on 10 March 2021, the commercial tenant of the gym, Virgin Active Health Clubs Limited ("Virgin"), giving notice of its intention to proceed with a Restructuring Plan under Part 26A of the Companies Act 2006, putting at risk the Manager's ability to recover arrears of around £355,384 payable in respect of contributions towards the costs of shared services, including electricity. The Second Respondent, Riverside CREM 3 Limited ("Riverside"), is Virgin's current immediate landlord. Prior to assigning its interest to Riverside on 21 November 2018, the Third Respondent, Canary Riverside Estate Management Limited ("CREM") was Virgin's immediate landlord.

7. In a judgment dated 1 April 2021, **[238]**, following a convening hearing, Snowden J identified the Manager as a 'General Property Creditor', meaning that his claims to service charges arrears (including electricity costs) will be compromised if the Plan is approved at the sanction hearing on 29th April 2021.

8. I listed the application for an urgent hearing that took place on 27 August 2021, as a 3–4 day Sanction Hearing is to commence in the High Court on 29 April 2021, at which the Court will decide whether to approve the Plan.

9. The Manager's application is not limited to the narrow issue concerning the Virgin shortfall. He seeks to protect his position in respect of the recovery of any bad debts which comprise a shortfall in the recovery of service charge expenditure from a leaseholder and which he has been unable to collect from that leaseholder.

10. In order to provide this decision to the parties promptly, I will refrain from describing the background circumstances that led to the appointment of Mr Unsdorfer's predecessor, Mr Alan Coates, as Manager in August 2016. The parties are familiar with that background which can be found in previous decisions of this tribunal and the Upper Tribunal. The current MO expires on 30 September 2021, but an application has recently been made to extend its term.

11. At the hearing on 27 August 2021, Mr Dovar represented the Manager, Mr Rainey QC represented Circus Apartments Limited ("CAL"), Mr Denehan represented the First to Third Respondents ("the Landlords"), and Mr Upton represented various leaseholders represented by the Residents Association of Canary Riverside. Mr Steadman, counsel, was present for Virgin as an observer, but made no representations.

The Management Order

12. The MO, at paragraph 4(a) **[33]** permits the Manager to:

> "receive all service charges, and interests payable under the Leases and to receive all service charges and interests payable under the Commercial Leases where the Commercial Leases and/or other occupiers have Shared Services with the residential lessees, and are

required, under the terms of their leases and/or Occupational agreements to contribute towards the cost of those Shared Services …"

13. The Interpretation part of the MO at (n) **[32]** defines Service Charges as including "the utility charges in respect of the Shared Services…". Shared Services are defined at (m) as meaning "any services or shared service provided to the Premises… which benefits (1) two or more residential units which are being managed by the Manager … or (ii) one or more Commercial Tenant … and one or more such residential unit."

Legal Framework

14. Section 24(1) of the 1987 Act confers power on this tribunal to make an order, appointing a manager to carry out, in relation to any premises to which Part II applies, such functions in connection with the management of the premises, or such functions of a receiver, or both, as the tribunal thinks fit.

15. Under section 24(4) an order of the tribunal may make provision with respect to such matters relating to the exercise by the manager of his functions under the order and such incidental or ancillary matters as the tribunal thinks fit.

16. Section 24(9) of the 1987 Act provides as follows:

    "9. The appropriate tribunal may, on the application of any person interested, vary or discharge (whether conditionally or unconditionally) an order made under this section; and if the order has been protected by an entry registered under the Land Charges Act 1972 or the Land Registration Act 2002, the tribunal may by order direct that the entry shall be cancelled."

17. S.24(9A) says as follows:

    9A "The tribunal shall not vary or discharge an order under subsection (9) on the application of any relevant person unless it is satisfied:

    (a) that the variation or discharge of the order will not result in a recurrence of the circumstances which led to the order being made, and

    (b) that it is just and convenient in all the circumstances of the case to vary or discharge the order.

18. In *Maunder Taylor v. Blaquiere* [2003] 1 W.L.R. 379 Aldous LJ, observed [at 35] that the 1987 Act was a radical piece of legislation which in a number of respects impinged upon the contractual rights of landlords, and [at 41] that its purpose is to provide a scheme for the appointment of a manager who will carry out the functions required by the court [or tribunal]. At paragraph 38 he said that there is no limitation as to the management functions of the manager, and, in particular, those functions are not limited to carrying out the terms of the leases.

19. In *Chuan-Hui and others v. K. Group and others* [2021] EWCA Civ 403 at [39] Henderson LJ referred to *Maunder Taylor* as clear authority for the proposition that a manager appointed under Part II of

LTA 1987 is a court-appointed official who is not necessarily confined to carrying out the duties of the landlord under the lease, and who performs the functions conferred on him by the tribunal in his own right.

20. A manager's powers or functions need not be confined to the premises which qualifies under s.21 of the 1987 Act. Although a causal link, or nexus, between the functions to be carried out by the manager and the particular premises is required, the functions to be exercised are not confined to the building its their curtilage, and can extend to amenity land (see *Cawsand Fort Management Co v Stafford* [2008] 1 WLR 371 (CA) at para.31). Further, as held in *Queensbridge Investments v Lodge* [2016] L&TR 19. [42-48] a management order can extend to giving a manager powers to manage commercial units and to collect rents from commercial tenants.

The Manager's Case

21. In Mr Unsdorfer's witness statement dated 22 April 2021, **[87]** he describes the services shared between the commercial and residential leaseholders as including: electricity (which, he says concerns an annual contract cost of £2 million, of which 60% is used by non-residential users); water supply; waste disposal; 24/7/365 security services; gardening; cleaning of communal areas; M&E plant maintenance; and CCTV monitoring.

22. He says the following in respect of the electricity supply:

> *"8. As can be seen from the above, the most onerous of these responsibilities relates to the contract for £2 million in annual electricity costs, more than half of which is consumed by the Hotel and other commercial tenants. Usually, a hotel and other large electricity consumers would have their own direct supplies and fiscal meters for which they would individually contract with the utility providers. However, that is not the case here. The Estate was originally wired up to a central supply which, like many other new developments of the period, allowed landlords to recharge electricity to tenants at a premium to the contracted cost. Whilst such profiteering was later outlawed, the supply infrastructure is unchanged on the Estate and has resulted in the burden on the Manager having to contract and advance-fund for vast supplies to nonresidential parts.*
>
> *9. The electricity contract is put out for tender annually in October for the most competitive rates of supply. The historic payment record and credit score are critical in influencing the deals which providers are prepared to offer on renewal. If any shortfalls in funds during the year results in late or missed payments, the provider could decline to renew and/or require advance payment of a security deposit of 20% in addition to a premium rate. There is also the real risk of disconnection of the supply to the entire Estate.*

10. *Using the current Virgin Active situation as an example of the ramifications of bad debts, the shortfall is approximately £355,384 which, if translated to late or missed monthly payments, could result in the provider requiring a security deposit of up to £400,000 as a condition of renewal. In aggregate terms, that would cause a cashflow problem of in excess of £700,000 and a risk that the supply will be cut off to the whole Estate including the residential parts."*

23. Although, in his application, the Manager sought to argue that the terms of the current MO permitted the recovery of Bad Debts from third parties, this was not pursued by Mr Dovar at the hearing of the application. He indicated in his skeleton argument that the Manager was, instead, content to focus on the issue of variation of the existing MO. This was clearly an appropriate decision. In my view, the existing MO makes no such provision. The Manager relied on the provisions of paragraph 4 of the MO, and in particular, paragraph 4(k) which allows him to recover "any costs, fees, charges expenses and/or disbursements reasonably incurred or occasioned by [him] in the appointment of any [lawyers etc]" for the purpose of enforcing any obligations owed by the landlord or any residential or commercial tenant through the service charge when the same cannot be recovered from the defaulting party". It is clear to me that the paragraph provides for the recovery of costs incurred in enforcing service charge obligations, and that it does not extend to recovery of an underlying debt. Nor does any other sub-paragraph of paragraph 4 allow this.

24. The variation proposed by the Manager is, firstly, to insert a new paragraph to the Interpretations section, defining a Bad Debt as meaning a "shortfall in recovery of service charge expenditure arising through an inability of the Manager to recover from a leaseholder for any reason, including but not limited to insolvency or any insolvency or company related legislation".

25. Secondly, he seeks the addition of a new paragraph 4(o) into the MO as follows:

"A. The Manager shall be able to recover any Bad Debt or any part thereof, which has arisen at any time, whether before or after the making of this Order in the following manner.

B. The Landlord shall be liable to pay the Bad Debt or any part thereof to the Manager, within 21 days of the Demand described below, where:

a.) There is no reasonable prospect of the Manager recovering the Bad Debt; and

b.) The Manager serves on the Landlord, a demand identifying:

a. the total sum claimed arising from the Bad Debt,

b. the manner in which it is calculated; and

c. if applicable,

i. the unit to which it relates;

ii. the lessee;

iii. the relevant lease provisions; and

iv. any demands served.

C. Prior to payment of the Bad Debt from the Landlord as set out above, the Manager is at liberty to recover the sum in the interim either from any sums held by way of reserve or by an interim service charge demand or by borrowing. In respect of the latter, the Manager shall be entitled to recover the sums borrowed plus interest as a Bad Debt.

D. For the purposes of this sub-paragraph, reference to 'the Landlord' is a reference to:

a.) firstly, the immediate landlord of the leaseholder whose failure to pay has given rise to the Bad Debt; and

b.) secondly, in the event that a Demand is served under this paragraph, but that too becomes a Bad Debt, then the landlord is the immediate landlord of the recipient of a notice under paragraph 4 (o) B b.)."

26. The Manager therefore seeks variations that will permit him to pursue recovery of a Bad Debt from, firstly, the immediate landlord of a defaulting leaseholder, and, secondly, if not paid, then the superior landlord. In addition, he seeks the ability to have temporary recourse to either the estate service charge reserve fund, or additional funding through the issue of interim service charge demands to avoid difficulties with cash flow.

The Landlords' Case

27. The Landlords' position is that, firstly, the tribunal has no jurisdiction to vary the MO in the manner and to the extent sought by the Manager, and, secondly, that if it has, the jurisdiction should not be exercised in the Manager's favour, as it is not just and convenient in all the circumstances of the case to do so.

28. The Landlords submit that it is clear from observations made in *Maunder Taylor* and *Chuan-Hui* that a manager appointed under s.24 is only entitled to receive funds to fulfil his or her functions and duties as a manager, where such funds constitute *service charge* receipts, payable by those obliged to pay for such costs under the terms of their leases. They say that this tribunal has no jurisdiction to empower a manager, under the terms of a management order, to place a new and burdensome financial obligation on a party to a lease. If s.24 was intended to extend that far, clear words would be needed, and none appear.

29. In Mr Denehan's submission, both the decisions in *Maunder Taylor* and *Chuan-Hui* support the proposition that unless expressly or impliedly provided for otherwise in a management order, the terms of the relevant leases continue to define the rights and obligations of the

parties to it, including the rights and obligations of the manager. He refers to paragraph 56 in *Chuan-Hui* where it was said:

> "The important point, in my judgment, is that the provisions contained in an order made under section 24 of the 1987 Act are superimposed on the existing contractual framework of the lease, but the underlying contractual rights and obligations of the parties remain in place, subject to the terms of the management order, and they are not permanently disapplied or modified. The Upper Tribunal was in my view substantially correct to say, at [53]:
>
> > "The imposition of a Management Order does not displace the lease covenants and the lessees remain bound by them."
>
> This sentence must, however, be read subject to the proviso that it refers to the underlying contractual framework, which remains in place subject to the terms of the management order. Plainly, to the extent that the terms of the order are in conflict with the underlying contract, the former must prevail while the order remains in force."

30. Mr Denehan contends that this is reflected in the Management Order in the opening words of paragraph 4, which provide as follows:

> "This final Order is for a period of five years commencing on 1 October 2016, the Manager is given all such powers and rights as may be necessary and convenient and in accordance with the Leases to carry out the management functions of the Landlord under the Leases … ;"

31. As such, he argues, the powers and rights of the Manager must be exercised in accordance with the "Leases" in order to carry out the management functions of the "Landlord" under the "Leases", and none of the Landlords are contractually or otherwise legally bound to pay bad debts under the terms of any Lease.

32. Referring to the decision in *Queensbridge Investments Limited v. Lodge and others* [2015] UKUT 635 (LC), Mr Denehan also emphasised that the the scope of a management order, and any variation to such order, must be proportionate. In that case Judge Huskinson said as follows:

> "43. The wording of the relevant statutory provisions is wide. The power in section 24(1) is to appoint a manager to carry out in relation to any premises such functions in connection with the management of the premises or such functions of a receiver or both as the F-tT thinks fit. It is functions in connection with the management of the premises which the manager can be appointed to carry out, not the functions of the particular landlord under the particular lease in question. See paragraph

38 and following in the judgments in *Maunder Taylor v Blaquiere*.

44. I accept that as a matter of general principle, as well as for the purpose of complying with the relevant human rights legislation including in particular Article 1 of the first protocol to the ECHR, there must be a reasonable relationship of proportionality between the terms of the management order and the aim sought to be realised, in the interests of the community, by the management order. … I respectfully agree with the Deputy President's analysis in paragraph 51 in *Sennadine Properties Limited v Heelis* where he stated that the scope of an order under section 24 should be proportionate to the tasks which the tenants are entitled under their leases to look to their landlord to perform. …".

33. In his skeleton argument, Mr Denehan argues that the proposed variations of the Management Order would result in a potentially unlimited financial burden being placed on the relevant landlord in respect of acts or omissions of tenants over which the Landlords have no control, and which do not arise through any default on the part of the Landlords. In effect, the variations sought would make the Landlords the ultimate guarantor of all service charge liabilities on the Estate. Further, he submitted that there is no legal or other justification for placing upon the freeholder, Octagon, liability to pay sums demanded by the Manager from the immediate landlords, CREM and Riverside when there is no privity of contract or estate between Octagon and the occupational tenants.

34. Even if this tribunal has jurisdiction to vary the MO in the terms sought, Mr Denehan contended that it should not do so as the Manager has not satisfied the legal and evidential burden of proof on him to establish that it is just and convenient in all the circumstances of the case to vary the MO. This application, he says, arises out of problems caused by a once in a generation pandemic, and that the variations sought are not proportionate to what the tenants of units on the Estate are entitled to expect. They would, in his submission, place the tenants in a better position than they otherwise would have been under the terms of their leases, and this would result in an uncovenanted windfall for the tenants, who would have a guarantor of the provisions of services.

35. Mr Denehan also submitted that this application is unnecessary because there is an existing mechanism in the flat leases which allows the Manager to recover money from other tenants to accommodate any shortfall in service charge receipts. Clause 26 of the specimen flat lease included in the Bundle **[881]** reads as follows:

26."<u>VARIATION IN SERVICE CHARGE AND PERCENTAGES</u>

> If due to any re-planning of the layout of the Estate or any part or parts thereof or the amount size or number of Properties to be provided in the Building or the units of residential or commercial accommodation to be provided in the remainder of the Estate or their respective uses or if it should otherwise at any time become necessary or equitable to do so the Landlord may recalculate on an equitable basis the percentages appropriate to the Dwellings and Commercial Units comprised in the Building …….and notify the Tenant of the variation appropriate to this Lease and in such case as from the date specified in any such notice the new percentage applicable to the Building Service Charge Percentage ….notified to the Tenant shall be substituted for those set out in this Lease.

36. Mr Denehan suggests that a landlord (or in this case the Manager) can rely upon this provision if it becomes necessary or equitable to do so and, therefore, if there is a shortfall in service charge income, for example due to the insolvency of a tenant, the landlord may recalculate the percentages payable by other tenants in order to make up that shortfall and provide the services. The tenants who own such leases, he submitted, acquired them knowing that their service charge liability could change as provided for in clause 26.

37. In Mr Denehan's submission, the proportionate, just and convenient way to address the problem faced by the Manager is for the MO to provide that Bad Debts are recoverable from the tenants via the service charge as it is those tenants who benefit from the services in question. This, he said, is broadly consistent with: the existing obligations of the tenants; the terms of the Management Order as currently drawn; and the provisions of the specimen flat lease included in the hearing bundle.

The Leaseholders' Case

38. The Leaseholders agree that the MO should be varied to make the Landlords responsible for the bad debts of any commercial or residential tenant, including the shortfall caused by Virgin's Restructuring Plan. They also agree that Riverside should be liable for any bad debt or shortfall arising by the failure of Virgin to pay service charges to the Manager, or, alternatively, as they are all part of the same group of companies, Octagon and/or CREM and/or Riverside should be liable.

39. They disagree, however, with the Manager's suggestion that on the proper construction of the MO, he is entitled to recover any shortfall arising by the failure of a commercial tenant to pay its service charge from the residential tenants.

40. They also object to the Manager's proposal to vary the MO to permit him, pending recovery of the bad debt from the Landlords, to recover any shortfall from the Leaseholders directly by way of an interim

service charge demand, or from sums held in reserve. They object to the suggestion that they be required to fund, on a temporary basis or otherwise, the working capital necessary for the provision of services (including utilities) to tenants who do not pay their service charge, and also object to the residential reserve fund being used for such purposes.

Circus Apartments Limited's case

41. CAL's position is that the arrears owed by Virgin should be paid by Riverside, as Virgin's present immediate landlord, but that in the unlikely event that it does not pay, by Octagon as the Landlords are all part of Yianis Group in any event. It adopts RACR's case on the appropriate form of variation.

Reasons for Decision

42. I do not agree with Mr Denehan's jurisdictional challenge. I do not accept that the observations made in *Maunder Taylor* and *Chuan-Hui* are authority for the proposition that a tribunal-appointed manager is only entitled to receive funds that constitute service charge receipts, payable by those leaseholders liable to pay such service charges. On the contrary, the decisions in both cases emphasise the broad range of powers available to a tribunal when formulating the terms of a management order (and any subsequent variations of the order). As was said in *Maunder Taylor,* there is no limitation as to the management functions that can be conferred on the manager. Such functions are not limited to carrying out the terms of the leases, and, as established in *Cawsand Fort* and *Queensbridge Investments*, they can extend to collection of rents from commercial tenants.

43. As stated in *Queensbridge Investments* [31] the purpose of s.24 is not to have regard to the rights and obligations under the lease, and to make sure that the manager carries out the provisions of the lease. It is directed towards creating a scheme of management which will ensure that the relevant premises are properly managed. When creating that scheme, the tribunal will seek to ensure that the manager has sufficient funds available to cover the costs of discharging his or her functions. In doing so, it is exercising its powers under either s.24(4)(a), to make provision for the exercise by the manager of his functions under the order, and/or under 24(4)(b) as incidental or ancillary matters.

44. I fully accept that in *Chuan-Hui* it was held that the imposition of a Management Order does not displace the lease covenants, and the lessees remain bound by them. But that underlying contractual framework is subject to the terms of the management order, and where the terms of an order conflict with the underlying contract, the terms of the order prevail for so long as it remains in force. In my determination, there is no fetter on the tribunal that prevents it from varying the MO to allow for recovery of the Virgin shortfall debt. As such, I do not consider that the terms of the Leases limit this tribunal's power to confer powers on the Manager under s.24(4)(a) or (b).

45. I also reject Mr Denehan' oral submission that the tribunal's powers are limited to those necessary to remedy the landlord's defaults that gave rise to need for a management order in the first place. The powers conferred by s.24(4)(a) or (b) entitle it to confer such functions on the manager as are required for the proper management of the premises, and can cover new circumstances arising after the making of the management order. That includes, where proportionate, making the landlord liable for the debt of one of its commercial leaseholders.

46. Having accepted jurisdiction, I turn to the question of whether, and how I should exercise my discretion. I do not consider the 'just and convenient' test in s.24(9)A is relevant to this application, as the Manager is not a 'relevant person' as defined in s.24(2ZA). However, if it did, then for the reasons stated below, I consider the test to be met.

47. What is, however, required, is that any variation to the MO is "proportionate to the tasks which the tenants are entitled under their leases to look to their landlord to perform (*Sennadine Properties v Heelis* [2015] UKUT 0055 (LC), para 51).

48. I agree with Mr Rainey, Mr Upton and Mr Dovar that a useful starting point is to first consider what the position would be if there was no manager appointment in place. I agree with their submissions that if a leaseholder fails to pay service charge due to a landlord, then that shortfall falls to be met from the landlord's own pocket, as leases do not require leaseholders to make up such a shortfall. Regardless of any shortfall, the landlord remains contractually bound under the leases to comply with its covenants, such as to provide services and to repair the building. It is, as Mr Upton said, a landlord's inherent risk that a tenant may default in paying its service charge, but it accepts that risk as it derives other benefits such as the rent payable and/or premiums on the grant of new leases.

49. If, as in this case, a s.24 manager is appointed, then unless there is contrary provision in the management order, the manager will be in the same position as a landlord, and is obliged to continue to perform his or her management functions despite any service charge shortfall. In this case, if, as appears likely, the Part 26A Restructuring Plan is approved, then, absent any variation in the terms of the MO, the Manager will remain liable in respect of the third party contracts he has entered into, including for the electricity supply to the Estate, despite the substantial shortfall debt owed by Virgin. As there would be no realistic prospect of the Manager recovering that sum from Virgin, the result, as things currently stand, is that the Manager would have to fund the shortfall himself.

50. That would not be an acceptable or viable situation. Mr Unsdorfer makes it clear in his witness statement that if the Virgin shortfall is not met then this could result in the electricity provider to the Estate requiring a security deposit of up to £400,000 as a condition of

renewal which would cause a cashflow problem of more than £700,000, and a risk that the electricity supply would be cut off to the whole Estate, including the residential parts. His evidence is not challenged, and such circumstances would, in my view, mean that the MO would have failed to achieve its purpose, and the management scheme is very likely to collapse through no fault of the residential leaseholders. That would be a thoroughly undesirable outcome, and one that this tribunal should endeavour to avoid. The shortfall therefore must be met from somewhere.

51. Mr Denehan submitted that the Manager could make use of clause 26 in the residential flat leases, to recover the shortfall from other leaseholders through the service charge, and that he should do so as it is those leaseholders who benefit from such services. I do not accept that submission, for the reasons advanced by Mr Rainey.

52. Mr Rainey drew my attention to paragraphs 37 of the decision of the Supreme Court in *British Telecommunications plc v Telefonica O2 UK Ltd and others*[2014] UKSC 42, where it was said that as a general rule, the scope of a contractual discretion will depend on the nature of the discretion and the construction of the language conferring it, and that in the absence of very clear language to the contrary, a contractual discretion must be exercised in good faith and not arbitrarily or capriciously. Further, this normally means that it must be exercised consistently with its contractual purpose.

53. In this case, I consider the contractual purpose of the clause, when read as a whole, and in the context of the entire lease, is directed towards varying service charge percentage contributions in relation to re-planning or restructuring of the Estate, meaning an increase or decrease in the number of units, or a change in the composition of those units, such as an increase in the number of commercial units.

54. I do not accept that the inclusion of the words "or if it should otherwise at any time become necessary or equitable to do so" empowers a landlord, or in this case, the Manager, to vary the percentage contributions because one of the leaseholders has defaulted in paying its service charge. I do not consider it credible that this was the parties' intention when entering into this form of lease. It would, as Mr Rainey pointed out, also require all of about 290 leases to be varied because of the non-payment by one leaseholder, which I do not see as being either necessary or equitable.

55. Secondly, I agree that this clause cannot operate retroactively. It permits a landlord to notify a leaseholder of an intended variation in percentage contributions, to take effect from a future date. It cannot now be used by the Manager to vary the percentages to recover costs already incurred and demanded from Virgin. Nor would changing the percentage contributions convert Virgin's bad debt into a service charge cost payable by other leaseholders.

56. I do not accept Mr Denehan's submission that the leaseholders should be responsible for meeting the Virgin shortfall as it is they that benefited from the provision of the relevant services. Yes, it is correct that they benefited from services such as the electricity supply together with the gym, but I see no reason why their contribution should be other that the percentage service charge contributions due under the terms of their leases. Further, as Mr Rainey pointed out, it is not accurate to characterise Riverside as deriving no benefit from the services supplied. Without the provision of the services the Virgin gym would not have been able to function, and Riverside would not have received its rent, nor the future rent it will potentially receive, as a class B landlord, if the Restructuring Plan is agreed.

57. In all the circumstances, I agree with Mr Rainey's submission that there is only one just, convenient and fair answer to the question of how the tribunal should vary the MO. That is that the landlord should be ordered to pay the Virgin bad-debt shortfall. Mr Denehan objects to such an order, arguing that the shortfall has arisen through no default on the part of the Landlords. There is no suggestion to the contrary. However, if it were not for the existence of the MO, it would Virgin's landlord, Riverside, who would bear the risk of Virgin's default. I do not consider the imposition of the MO should alter that *staus quo* and, in my determination, the MO should be varied to preserve it, so that the Manager remains able to continue to discharge his functions under it.

58. I do not agree with Mr Denehan's submission that to do so would result in the imposition of an inappropriate financial burden on Riverside. The risk, and potential financial burden, that a commercial tenant may become insolvent is a risk to be borne by its landlord, and not by a tribunal-appointed manager, or other leaseholders. To vary the MO in this way would not result in the imposition of a new burden, but instead prevents Riverside from escaping liability for a bad debt by reason of the existence of the MO, that was itself imposed because of the landlord's defective management of the Estate. I therefore reject Mr Denehan's contention that such a variation places the tenants in a better position than they otherwise would have been under the terms of their leases. It does not. It maintains the status quo that existed prior to the making of the MO in which Riverside would, in effect, have been contractually liable under the leases to bear the cost of the Virgin bad debt, as it would have had to continue to meet its obligations under the residential and commercial leases, regardless of the shortfall.

59. I accept that Riverside will suffer a financial loss if the Part 26A Restructuring Plan is approved. However, as Mr Rainey and Mr Dovar pointed out, Riverside is a class B landlord under the proposed Plan, and although all outstanding rent arrears will be discharged if the Plan is approved, Riverside will still be paid its future rent (see paragraph 38(ii) of the Convening Judgment **[246]**). That rent, said Mr Rainey and Mr Upton, would cover the service charge shortfall in 6 months, and if Virgin defaults on that rent, Riverside can forfeit its lease, as its

right to do so is unaffected by reason of the existence of the MO, or the proposed Plan (see paragraph 36 at **[245]**.

60. However, I do not consider it proportionate to vary the MO to make the other Landlords, CREM and Octagon, liable to pay the Virgin bad debt if Riverside does not pay it. The only reason advanced by Mr Dovar for passing the potential for bad debt recovery up the chain of title was that the companies are all within the Yianis Group, with the same ultimate owner, Mr John Christodoulou. That is not, in my view, a good reason, at this stage, to make anyone other than Riverside, Virgin's immediate landlord, liable to pay the Virgin bad debt to the Manager. Prior to the imposition of the MO it was the immediate landlord who bore the risk of Virgin defaulting and this status quo should be preserved.

61. If Riverside does not pay, the Manager can seek a further variation to the MO, or seek directions. As both Mr Rainey and Mr Upton pointed out in their skeleton arguments, in the event that Riverside defaulted on this obligation to pay, this tribunal could confer on the Manager the right to receive the rent due to Riverside, up to the level of the Virgin shortfall, similar to the order upheld by the Upper Tribunal in *Queensbridge Investments*. Mr Upton also suggested that the tribunal may, in future, be invited to revisit the question of how the Manager enforces the payment of service charges generally, including varying the Manager's powers in respect of forfeiture. These, however, are issues for another day.

62. Nor am I satisfied that it is proportionate, at this stage, to vary the MO to make the Landlords liable for *any* bad debt arising from *any* defaulting leaseholder, as the Manager seeks. This is for two reasons. Firstly, if I were to order such a variation, I consider it should be against the immediate landlord only. My understanding is that broadly speaking, CREM is the Landlord in respect of the residential units, and Riverside is the Landlord in respect of the non-residential units. I am not, at present, satisfied that it is proportionate for me to order that the landlord of the non-residential units be responsible for paying bad debts incurred by residential leaseholders, and vice versa.

63. Secondly, before making such a variation, I would want to see a full explanation as to the mechanism by which a service charge debt would be classified as a bad debt. In the Manager's proposed variation, a 'Bad Debt' debt is defined as meaning a shortfall in the recovery of service charge expenditure arising through an inability of the Manager to recover from a leaseholder, for any reason, including but not limited to insolvency, or any insolvency or company related legislation. However, no explanation has been given as the point at which the Manager is reasonably entitled to conclude that that recovery is no longer possible, and what other remedies he must first pursue.

64. In the present case, that conclusion is easily reached. My reading of the Convening Judgment is that the Restructuring Plan appears likely to be approved. If it is not, then there appears to be no realistic prospect of

the Manager recovering the shortfall in any event, as based on the figures provided by the Plan Companies, there is a material risk that in the absence of the Restructuring, they will run out of money in the week commencing 17 May 2021 (paragraph 25 at [243]. The need for the variation is therefore clear. However, I do not consider it proportionate to vary the MO to grant the Manager the blanket right to seek to recover any unpaid service charge sums from any of the Landlords without clarity as to how a such a debt crystallises to become an unrecoverable bad debt.

65. I also reject as disproportionate the Manager's proposed variation allowing him to recover bad debts, in the interim, from either sums held in the service charge reserve, or through service of an interim service charge demand on leaseholders. I agree with Mr Upton that nothing in the current wording of the MO makes the residential leaseholders responsible for the bad debts of any commercial tenant, and I see no reason why the residential leaseholders should be made liable for the bad debts of other leaseholders. In addition, recourse to the reserve fund, even on a temporary basis, might be inappropriate given that monies in the reserve are held on trust for the leaseholders. If the Manager has cash flow difficulties pending recovery of the Virgin debt from Riverside then paragraph 4(n) of the MO allows him to have recourse to borrowing in order to ensure he can continue to perform his functions and duties.

Conclusion

66. In all the circumstances of this case, I determine it proportionate, just, and convenient to vary the Management Order to insert a new paragraph 4(o) in the form set out in paragraph 2 above. I consider the variation in the MO should cover both existing and any future service charges outstanding from Virgin as further sums may accrue between now and approval of the Restructuring Plan, or Virgin's potential insolvency. It is open to Riverside to apply to the tribunal to vary that provision if Virgin's position stabilises.

ANNEX - RIGHTS OF APPEAL

Appealing against the above tribunal decision

1. A written application for permission must be made to the First-tier Tribunal at the Regional office which has been dealing with the case.

2. The application for permission to appeal must arrive at the Regional office within 28 days after the date this decision is sent to the parties.

3. If the application is not made within the 28-day time limit, such application must include a request for an extension of time and the reason for not complying with the 28-day time limit; the Tribunal will then look at such reason(s) and decide whether to allow the application for permission to appeal to proceed despite not being within the time limit.

4. The application for permission to appeal must state the grounds of appeal, and state the result the party making the application is seeking.