Neutral Citation Number: [2024] UKUT 175 (LC)

Case No: LC-2023-440
LC-2023-441

IN THE UPPER TRIBUNAL (LANDS CHAMBER)
AN APPEAL AGAINST A DECISION OF THE FIRST-TIER TRIBUNAL (PROPERTY CHAMBER)
FTT REF: LON/00BG/LSC/2021/0287

26 June 2024

TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007
APPEAL FROM A DECISION OF THE FIRST-TIER TRIBUNAL (PROPERTY CHAMBER)

LANDLORD AND TENANT – SERVICE CHARGES – whether charges reasonably incurred – insurance commission – retention of commission by broker - considerations relevant to whether charges reasonably incurred when the landlord was committed to them under a long-term agreement

BETWEEN:

LIAM PHILIP SPENDER AND 103 OTHERS

Appellant

-and-

FIT NOMINEE LIMITED AND FTT NOMINEE 2 LIMITED

Respondent

Various Properties at St. David's Square,
Westferry Road,
London,
E14 8JS

Upper Tribunal Judge Elizabeth Cooke
23 April 2024

Mr Liam Spender for the appellants
Mr Simon Allison for the respondent, instructed by JB Leitch Limited

The following cases are referred to in this decision:

Auger v London Borough of Chelsea (2008) LRX/81/2007
Azhar v All Money Matters [2023] EWCA Civ 1341
Burr v OM Property Management [2013] 1 WLR 3071
Continental Property Ventures v White (2006) EW Lands LRX/60/2005
Cos Services Limited v Nicholson and another [2017] UKUT 382 (LC)
Daejan v Benson and others [2013] UKSC 14
London Borough of Lewisham v Rey-Ordieres and others [2013] UKUT 14 (LC)
Octagon Overseas Limited and anr v Cantlay and others [2024] UKUT 72 (LC)
Patel and others v Spender and others [2024] UKUT 62 (LC)
Waaler v Hounslow London Borough Council [2017] EWCA Civ 45
Williams v Southwark London Borough Council (2001) 33 HLR 22

Introduction

1. This is an appeal from a decision of the First-tier Tribunal ("the FTT") made in exercise of its jurisdiction under section 27A of the Landlord and Tenant Act 1985 to determine whether service charges are payable. The FTT made a number of determinations in relation to the service charges demanded of leaseholders in St David's Square, a large residential development on the Isle of Dogs; just two of those determinations are appealed, one by the leaseholders and one by their landlords who are the freeholders of the development.

2. The leaseholders have been designated the appellants and the freeholders as respondents and cross-appellants, but these are two appeals on two different points and I refer to the parties as "the landlord" and "the leaseholders" throughout for the avoidance of confusion. In the FTT the leaseholders were the applicants and the landlord the respondent.

3. 92 leaseholders were applicants in the FTT; four further leaseholders joined in the application for an order under section 20C of the Landlord and Tenant Act 1985 (preventing the landlord from recovering its litigation costs from the leaseholders as service charges). In the Upper Tribunal those 92 appellants appeal the two substantive points, and the further four together with 30 more leaseholders have joined in only in order to make a further section 20C application in respect of the appeal proceedings. A list of the participating leaseholders is appended to the decision.

4. The leaseholders were represented in the appeal by one of their number, Mr Liam Spender, and the freeholders by Mr Simon Allison of counsel, and I am grateful to them both.

St David's Square and the disputed service charges

5. St David's Square was built between 1998 and 2003. It comprises 436 long-leasehold flats in large blocks and 40 freehold houses in two terraces along the northern and eastern edges of the estate. FIT Nominee Limited and FIT Nominee 2 Limited together own the freehold, and have done so since 2014.

6. St David's Square was the setting for a recent decision of this tribunal, *Patel and others v Spender and others* [2024] UKUT 62 (LC), on an application under section 84 of the Law of Property Act 1925 for the modification of covenants burdening some of the freehold houses. I visited the development in connection with that application. The freeholders and 104 of the leaseholders were the successful objectors in those proceedings.

7. The estate is rectangular and is bordered by the river to the south. There are estate roads, gardens and some communal facilities including a gym. The leases are in unsurprising form and I have been provided with a copy of the lease of one of the flats by way of sample. It is bi-partite, between landlord and tenant only. It sets out the landlord's obligations, including the insurance of the estate, and requires the leaseholder to pay a service charge to reimburse the landlord's expenditure. There is no dispute between the parties about the terms of the lease. The estate is run by a managing agent for the freeholders, FirstPort Bespoke Property Services Limited ("FirstPort").

8. The leaseholders applied to the FTT for a determination as to whether certain service charges demanded in respect of 2018, 2019 and 2020 were payable.

9. The FTT's jurisdiction to make that determination arises from section 27A of the Landlord and Tenant Act 1985, which enables it to decide whether a charge is payable and, if so, in what amount, to whom, when and how it is payable. One reason why it might not be payable is that the cost which it reimburses was not reasonably incurred; section 19 of the 1985 Act says this:

> "(1) Relevant costs shall be taken into account in determining the amount of a service charge payable for a period—
>
> (a) only to the extent that they are reasonably incurred, and
>
> (b) where they are incurred on the provision of services or the carrying out of works, only if the services or works are of a reasonable standard;
>
> and the amount payable shall be limited accordingly."

10. As I said above, only two of the charges about which the FTT was asked to make a decision are relevant to this appeal, and it will be convenient for me to explain what the FTT decided, and to decide the appeal, in relation to each of those two charges separately.

The insurance commission

11. The sum in issue here is less than £5 for each leaseholder, in total, for the three years in dispute; Mr Spender described it as an issue of principle.

The leaseholders' challenge to the insurance costs

12. Service charges were demanded of the leaseholders, in each of the three years in question, in reimbursement of the cost of various insurances other than the main buildings insurance, including insurance for the gardens, external common parts and the roads. These insurances were arranged for the landlord, by a broker, First Port Insurance Services Limited ("FPIS"), part of the same corporate group as the managing agents of the estate, FirstPort (and said by the leaseholders to be in common ownership with FirstPort). The landlord of course paid an insurance premium, which the leaseholders were then required to reimburse as service charges.

13. The leaseholders' challenge is to the commission retained by FPIS. Their argument before the FTT was that it was not reasonably incurred by the landlord because it was not a payment for services provided by FPIS; they argued that a commission of about one-third of the amount retained by the broker for the three years in dispute would be appropriate. In effect their case was that the broker's profit margin was too high.

14. The leaseholders relied upon *Williams v Southwark London Borough Council* (2001) 33 HLR 22 a decision by Lightman J on a challenge to service charges in respect of insurance premiums. In that case the landlord arranged insurance itself, and passed the premium on to the tenants. The broker allowed it to retain 25% of the premium by way of commission. Of that 25%, 5% was a payment for repeat business, or a loyalty payment; the other 20% represented a payment for the handling and administration of certain claims on the policy. Lightman J found that the landlord was entitled to retain the 20%, which was a payment for services, but the landlord conceded that it must account to the tenants for the 5% it received by way of loyalty payment.

15. The leaseholders also relied upon *Cos Services Limited v Nicholson and another* [2017] UKUT 382 (LC), where the Tribunal (HHJ Stuart Bridge) held that the whole of what the landlord spends on insurance, including premium and any commission retained by the broker, must be reasonably incurred in order to satisfy the requirements of section 19(1)(a). In that case there was an obvious discrepancy between what the landlord was paying and the premiums obtainable from other insurers in the market, which the landlord could not explain, and the Tribunal upheld the FTT's decision that the premium was not reasonably incurred to the extent of that discrepancy.

16. In response to the leaseholders' argument the landlord called a witness in the FTT, Ms Liza-Jayne Amies, who made a witness statement. She pointed out that brokers earn their money from commission agreed with the insurer and deducted from the premium paid by the policyholder. She explained the services provided by FPIS to its client the landlord, including the analysis of the market consideration of the policy on offer, keeping cover under review during the term of the policy and acting for the landlord if a claim is made. Ms Amies did not attend the hearing before the FTT; very shortly before the hearing it was said that she could not be released from her duties at work.

The decision of the FTT

17. The FTT's decision on this issue was very shortly expressed. It said:

> "55. The leaseholders said the charges were excessive and proposed a reduction of about 2/3. Mr Spender said it was a point of principle as FirstPort were already
> getting the management fee. [Ms Amies] the director of insurance had put in a witness statement but not attended. He said that limited weight should be given to her evidence. There were a number of questions that Mr Spender would have liked to have asked [Ms Amies] but was unable to ask. It was impossible for him to get a like for like quote in relation to the block policy.
>
> 56. Mr Allison said it was wrong to challenge the commission as a matter of law. He said that the Tribunal was not here to assess the Commission received by the insurance broker. [FPIS] were part of the same entity but were a separate entity and were entitled to charging Commission.

> 57. Mr Allison is correct that the premium was not proven to have increased by the commission therefore the Tribunal has no role in this matter. There were no comparators in any event."

18. That last paragraph is not easy to understand, but I accept Mr Allison's suggestion that what was meant was that the leaseholders had not established that they were paying any more than they would have paid had the landlord used a different broker.

The appeal

19. The leaseholders have two grounds of appeal.

20. The first is that the FTT was wrong to find, in favour of the landlord, that the commission had not increased the premium when the landlord's witness was not present for cross-examination. Mr Spender said that he would have cross-examined Ms Amies on her assertions that services were provided, which the leaseholders dispute. The second is that the decision was wrong in law and in fact; the premium would have been lower but for the commission, FPIS did not provide services in return for the commission and the landlord can only recover the cost of commissions charged by FPIS if they represent a service performed to a reasonable standard; "FPIS has claimed remuneration for work it has not done".

21. Mr Allison argued that the analogy drawn by the leaseholders with *Williams v Southwark* does not work. The landlord in the present case is the broker's customer. The landlord uses a broker to get insurance, and has to pay what the broker charges. The leaseholders presented no evidence that the insurance premium (from which the commission was deducted) was not a reasonable rate or was more expensive than the landlord would have had to pay if a different broker had been used. Moreover, the leaseholders' challenge is not one that the FTT has jurisdiction to decide; they are not challenging the premium itself, only the fact that FPIS retained so much by way of commission. And the FTT has no jurisdiction over the level of profit made by an insurance broker or any other third party.

22. Neither party referred in argument to the Tribunal's decision in *Octagon Overseas Limited and anr v Cantlay and others* [2024] UKUT 72 (LC) – understandably as it was published very shortly before the hearing, and I too was unaware of it at the time of the hearing. *Octagon* was a challenge to insurance premiums which included an element of commission; the Landlord was placing the relevant insurance via its asset manager (its agent), a connected company: Westminster Management Services Ltd ("WMS"), and they in turn were placing cover via an insurance broker, Reich. A commission was paid by the insurer to Reich and shared between Reich and WMS. The leaseholders argued that the commission retained by WMS was not reasonably incurred by the landlord. For the leaseholders it was argued (as set out at paragraph 31 of the Tribunal's decision):

> "that leasehold property insurance is unique in the insurance market in that the person taking out the policy (usually the landlord) is not the person who will ultimately pay the premium. Not only did this remove the incentive to negotiate a lower premium but, additionally, 'the leasehold property insurance market has developed financial mechanisms that, perversely, increase premiums by benefitting landlords (and their agents) at the expense of leaseholders'".

23. The Deputy President, Martin Rodger KC, said at paragraph 32:

> "Whether [the leasehold property insurance] market is unique, and whether it operates in a way which is perverse, are not issues which can be addressed on the limited evidence in this case, but the general complaint that leaseholders are in a vulnerable position which may lead to them being required to pay more for insurance than is reasonable, features in almost every insurance case the FTT has to determine. The suspicions of leaseholders that they are being exploited are often magnified by a lack of transparency in the arrangements which have been made, and by the structure, practices and terminology of the insurance market of which few of them will have much experience. The potential for abuse is obvious where the party seeking to obtain a policy of insurance is simultaneously offering to provide services (such as claims handling) in return for a fee which the insurer will return to the insured out of the gross premium it charges for the policy."

24. *Octagon* came to my attention while I was writing this decision, and I wrote to the parties asking for their observations upon it. I suggested to them that the above extract from the Deputy President's decision is an apt description of what happened in the present case, where FPIS' commission was justified by the assertion that it was a payment for services – a justification which the leaseholders sought to challenge as a matter of fact but were not able to do so because of Ms Amies' absence. Moreover FirstPort (the landlord's agent) and FPIS were not, according to the leaseholders, at arms' length because they were connected companies; the potential for abuse was, again, obvious.

25. The general rule in a challenge to service charges under section 19(1)(a) is that the leaseholders must raise a prima facie evidential case, generally by showing that the service concerned could have been obtained more cheaply. In this case the leaseholders could not do that. Instead their argument was that there was obviously something wrong because the commission was inexplicably high. The landlord's answer, which the FTT accepted, was that unless there was evidence that the insurance premiums were inflated by the level of commission payable to FPIS there was no basis for a challenge to the cost the landlord had incurred.

26. This is the situation described by the Deputy President said in *Octagon* at paragraph 61:

> "The leaseholders more than adequately discharged the burden of raising a prima facie case that needed to be answered by establishing that the premiums they were required to pay were not the result of an arm's length negotiation in an open market and included undisclosed sums to take account of services which the Landlords' agent had agreed to provide in return for a commission calculated as a percentage of the premium. It was then for the Landlords to show what work had been done to justify that commission, and why the commission itself was reasonable."

27. In the same way, I take the view that the leaseholders did not need to go further than they did in this case to show that something was prima facie wrong. It was then for the landlord to show either that the commission was a reasonable price to pay for the services provided by FPIS in light of the extent of those services, or that it could not have obtained a better deal by making a different arrangement, whether with that broker or a different one, that did not involve those services. The landlord chose to do the former, which means that Ms

Amies' absence did matter and the leaseholders should have had the opportunity to challenge her evidence.

28. Both parties responded to my observations. Mr Spender filed a second response, on 6 June 2024, without permission and I disregarded it.

29. In response to my observations Mr Allison argued first that the situation described by the Deputy President in paragraph 32 of *Octagon,* above, could be said to apply to any service charge. So it could in a sense, but the Deputy President's observations were made in response to the argument that insurance is a particularly difficult market, where technical language and lack of transparency can make it almost impossible to know what is happening and who is being what, let alone to bring a challenge.

30. Second, Mr Allison argued that the situation in the present case does not match that in *Octagon*. There the landlord arranged the insurance through its asset manager and kept a commission. In the present case:

> "a. L's asset manager (Freehold Managers) plays no part in placing the insurances that the FPIS commission relates to.
>
> b. FPIS itself is not connected to / associated with L. It is admittedly in the same corporate group as FirstPort, L's managing agent, but that is at least one further step removed from the Octagon arrangement.
>
> c. Most importantly, FPIS is not an agent of L (as was considered in oral submissions at the hearing) – unlike WMS in Octagon. FPIS is itself an insurance brokerage business, placing insurance for (i.e. selling to) L, and taking a commission in return for that work. L does not take the commission, nor does FirstPort (L's agent)."

31. That is to miss the point that FirstPort was the landlord's agent; its position was analogous to that of WMS; and FPIS, while not connected to the landlord, is closely connected to the landlord's agent, FirstPort, so that the arrangement between FPIS and FirstPort does not appear to be at arm's length. The structure is slightly different from that in *Octagon* but the mischief identified at the Deputy President's paragraph 32 is the same: in view of the close connection between the party seeking the insurance (FirstPort, as agent for the landlord) and the broker, there is ample scope for these three parties – the landlord connected to FirstPort by agency, FirstPort to FPIS by company structure – to negotiate arrangements involving commission, which the tenants have to pay for but which does not confer any benefit on them because it is an inflated fee for what the broker does.

32. Finally it is argued for the landlord that even if its arguments above are not accepted, the evidence of Ms Amies was irrelevant. There was no point in the landlord's demonstrating that the commission was a fair price to pay for services because the landlord is not taking the money. "It would be like asking L to justify the profits of its unconnected window cleaner or gardener." However, that is again to miss the agency point. Here the landlord's agent is getting the insurance through a broker that is a connected company. So it is for the landlord to prove either that the deal agreed by the agent (and therefore the cost incurred by the landlord) was at a competitive rate, or to show that what the broker was paid was a reasonable price for what it did.

33. In my judgment in going ahead without Ms Amies' evidence the FTT ensured that the landlord was unable to answer the leaseholders' challenge, which contrary to the landlord's argument was enough to shift the evidential burden to the landlord to show that the price paid was reasonable, either by reference to the market and the available arrangements or by showing that the price paid reflected services carried out. The FTT therefore failed to take all relevant points into consideration and I set its decision aside.

34. Instead of remitting the matter to the FTT, which would be disproportionate to the amounts involved, I substitute the Tribunal's decision that the landlord has not shown the commission retained by FPIS was reasonably incurred. Insofar as those costs are part of the charges challenged by the leaseholders for the three years in question in this appeal, they are not payable; but I have not made any positive finding that the costs were *not* reasonably incurred so that the point remains open in any future challenge. The sums payable by all the leaseholders together for the insurance brokered by FPIS, for each year in questions are:

    For 2018: £8,430.92

    For 2019: £9,300.05

    For 2020: £10,223.61

Countryside contracts

35. I turn now to the second of the decisions appealed. This time it is the landlord who appeals the FTT's decision that certain costs were not reasonably incurred.

The contracts and the payments

36. The costs in question were rental and maintenance charges paid by the landlord to Countryside Communications Limited ("Countryside") for the security system for the estate including the door video intercom and remote release systems, TV and satellite services, car park gates and barriers and leisure centre CCTV and alarms. This was a substantial charge each year, just over £200,000 altogether in 2018 and similar sums in 2019 and 2020; the charge to the individual leaseholder was several hundred pounds each year, which the leaseholders said amount to 10% or 11% of the total service charge.

37. These charges were challenged by the leaseholders in the FTT, for the years 2018, 2019 and 2020 only, on the basis that the cost of renting and maintaining this system each year was about half the cost of buying a new system outright, and that the cost of maintaining a new system would be a fraction of what they were paying to rent and maintain the present one. Accordingly it was unreasonable to spend this "eye-watering" sum, as Mr Spender put it, and the cost was not reasonably incurred as section 19(1)(a) of the 1985 Act requires.

38. The landlord's answer to that, in the FTT and in the appeal, is that the developer entered into a series of contracts, each for a 20-year term, with Countryside in July 2000, and that the landlord had taken over that contractual liability and remained bound by those contracts until their expiry. The price of rental and maintenance was fixed, subject to RPI

increases; there was an option to terminate the contract in 2007 and 2014, at the price of four times the annual rental, which unsurprisingly the landlord did not exercise.

39. Over time, that price became increasingly expensive as technology advanced and costs reduced. In 2008 some of the leaseholders challenged the costs, and a settlement was reached between them and the landlord's predecessor in title that the amount charged to the leaseholders from then on would be capped at 90% of the then level of payment, without further RPI increases. The landlord has kept to that agreement which is why charges have remained constant.

40. The contracts were for a term of 20 years and then from year to year, and could have been brought to an end in July 2020; but in fact the landlord missed the boat and did not give notice of termination of the contract to Countryside in time, with the result that the contracts rolled on. After that, the landlord carried out a tendering exercise for the purchase of a new system, and at the same time sought to negotiate a new deal with Countryside. It then consulted the leaseholders about the available options, with the result that since 1 January 2022 the Countryside system remains in place but the charge is at about 50% of previous levels.

41. In view of that the landlord conceded in the FTT that the charge for the second half of 2020 should be reduced by 50% (i.e. a 25% reduction in the charge for the year). That was unsatisfactory to the leaseholders; their case in the FTT was that the charge should have been just under 20% of its then current level, on the basis of comparison with present-day maintenance costs for similar systems when owned rather than rented.

The FTT's decision

42. The FTT's decision was that the cost of the Countryside system in the three years in question, in the amount charged to the leaseholders, was not reasonably incurred. It was critical of Mr Williams, the development manager for FirstPort who gave evidence for the landlord, who was not aware of the contracts when he raised the purchase order to trigger the payments to Countryside. It said "the bad deal made in 2000 was still a bad deal in 2018", that the system was "foisted" on the leaseholders; and the effect of section 19 was that the tenants should not have to pay the full cost of those contracts in the years in question. It did not decide what would be a reasonable payment in its decision of 22 March 2023, but asked the landlord to obtain from Countryside a breakdown of the cost into rental and maintenance.

43. That breakdown was not forthcoming; Countryside told the landlord that it charged a fixed fee under the contracts and no breakdown into rental and maintenance costs existed. Therefore in a supplementary decision of 3 May 2023 the FTT adopted the figures obtained by FirstPort for an equivalent level of maintenance for a new system, and determined that the costs of the Countryside contracts were reasonably incurred only to the extent of a figure that represented 19% of the charges demanded by the landlord. From that determination the landlord appeals.

The landlord's arguments in the appeal

44. For the landlord, Mr Allison points out that had the Countryside contracts been made a few years later they would have been "qualifying long-term agreements" ("QLTAs") and subject to the consultation requirements of section 20 of the Landlord and Tenant Act

1985 – which were introduced by section 151 of the Commonhold and Leasehold Reform Act 2002. Mr Allison did not suggest that that makes any difference to what I have to decide in the appeal, and I agree it makes none.

45. The landlord's argument is that the FTT made a decision about what was done in 2000 and indeed did so without evidence: there was nothing to suggest that the contracts were in fact a "bad deal" in 2000. But in fact its jurisdiction under section 19 is to determine whether the landlord's costs were reasonably incurred. As both parties agree, the cost (that is, the charge made by Countryside) was incurred when payment was demanded: *Burr v OM Property Management* [2013] 1 WLR 3071. And the landlord in incurring those costs in 2018, 2019 and 2020 was bound by the contracts to make those payments to Countryside; it cannot be said that that was an unreasonable decision given that the landlord's options were either to pay, or to not pay and be sued by Countryside - or, at worst, have Countryside remove or disable its equipment, which would have placed the landlord in breach of its covenants under the lease.

46. Mr Allison relies upon the decision in *Auger v London Borough of Camden* (2008) LRX/81/2007. That was an appeal from a decision of the London Rent Assessment Panel on an application by the London Borough of Camden for a dispensation from the consultation requirements of section 20C of the 1985 Act in respect of "Partnering Agreements" which it proposed to enter; under that agreement a programme of capital works would be carried out to Camden's housing stock over a period of years, with the contract rate determined by the Partnering Agreement. One of the reasons why the LVT granted the dispensation sought was that it took the view that there would be no disadvantage to the leaseholders because they would still have the protection of section 19 of the 1985 Act and would be able to challenge the resulting service charges. The Lands Tribunal (HHJ Huskinson) allowed the leaseholders' appeal, accepting their argument that section 19 would not protect them. The judge said this:

> "47. …I accept [the leaseholders'] arguments … that once the Partnering Agreement(s) is/are in place there will be difficulty for the tenant to say that the amount of costs incurred under such Partnering Agreement(s) on qualifying works was unreasonably high. We are not here concerned with whether the works to be carried out are reasonably necessary or are carried out to a reasonable standard − in respect of such points the tenants would still have substantial protection under section 19 of the Act. However, as regards works which the tenants accept are reasonably necessary and done to a reasonable standard, there may still be a question which the tenants wish to raise as to whether the cost which Camden seek to charge through the service charge in respect of carrying out such works is reasonable. The provisions of section 19(1) provide that relevant costs are to be taken into account only to the extent that they are "reasonably incurred". If works which are reasonably necessary and are done to a reasonable standard are carried out under a Partnering Agreement Camden will be able to meet criticism regarding the level of expense by pointing out that Camden is already contractually bound to the Partner and had to place the works with the Partner at the contract rate provided for in the Partnering Agreement, and therefore the costs were indeed reasonably incurred because, even if the works could reasonably have been expected to have been done significantly cheaper by other competent contractors, Camden would be in breach of contract by giving the works to anyone other than the Partner."

47. That passage was quoted with approval in *London Borough of Lewisham v Rey-Ordieres and others* [2013] UKUT 14 (LC) at paragraph 44, although the outcome was different in that case because the costs under the contract in question were not entirely inflexible. But the passage quoted above from *Auger* describes the present situation exactly, Mr Allison argued: there is no question about the quality of the work, only about the decision to incur the cost, and in the present case as in the situation imagined in *Auger* the landlord's hands were tied and there were no other realistic options open to it.

48. What the FTT did, according to Mr Allison, was to fall into the trap analogous to the one encountered in historic neglect cases, where it is argued that a cost for repair was not reasonably incurred because it would have been cheaper if the landlord had done the works years earlier. The landlord's decision to incur the cost has to be assessed now, in the position in which the landlord finds itself (although the tenants may be able to set off a claim in damages for breach of covenant in the historic neglect: *Continental Property Ventures v White* (2006) EW Lands LRX/60/2005).

49. Furthermore, Mr Allison argues that the supplemental decision of 3 May 2023, when the FTT reduced the amount payable by 81%, was irrational, first because the FTT was using as a comparator the cost of maintaining a new system, which is likely to be lower than an old one, and second because in allowing the landlord to charge for maintenance costs only (even had it done so accurately) means that the leaseholders got the system for free – no allowance is made for the fact that in reality the landlord does not own the security systems.

50. Mr Allison adds that it is likely that all or most of the leaseholders were aware of the rented security system, which was in place by the time most of the leases were granted, so it was not – as the FTT seemed to think – that they were taken by surprise by it; in any event the terms of the lease requiring the landlord to provide security systems explicitly state that the landlord may hire such systems.

The leaseholders' arguments in the appeal

51. Mr Spender put forward a number of reasons why the FTT's decision was correct.

52. His primary argument was that the landlord was not bound by the Countryside contracts because there is no evidence that the contracts had ever been novated to it.

53. If that is true then the landlord's argument would collapse; it would no longer be able to point to its contractual commitment to justify the expense. Had that been the leaseholders' case in the FTT, and had it succeeded, their challenge would have been successful.

54. However, that was not the leaseholders' case in the FTT. There is no mention of it either in their initial pleadings (the relevant document is their reply to the landlord's defence, dated 1 April 2022) or in the Scott Schedule where the parties' cases were set out in detail. The leaseholders' argument in the Scott Schedule was simply that the costs were excessive.

55. In Mr Spender's skeleton argument in the FTT he observed, very briefly in one short paragraph (15), that there was no evidence of novation. When this was raised at the hearing the landlord was able to produce the 2008 settlement agreement, which referred to the novation of the contract to the landlord's predecessor in title. Mr Allison's recollection

was that the point was not pursued before the FTT and was mentioned only briefly by both advocates in closing. There was no application to amend the leaseholders' statement of case in the FTT to rely on this point. Had there been, I have no doubt it would have been refused because it was far too late to raise it; it could not fairly have been relied on unless the landlord had warning of the point. The landlord would have had to be given the opportunity to produce relevant evidence (including perhaps evidence from Countryside itself) and also to raise the obvious point under section 27A(4) of the 1985 Act, namely that past payments by the leaseholders of sums demanded for the security system could amount to an agreement that the landlord was contractually bound to pay for the system.

56. For the same reason I refused to allow Mr Spender to rely upon the point on appeal; it was not part of his case in the FTT and cannot be raised afresh now when the time for calling evidence is past. If authority for that obvious point of fairness be needed, it can be found in the Court of appeal's decision in *Azhar v All Money Matters* [2023] EWCA Civ 1341.

57. Mr Spender then had four further arguments, each of which he said was sufficient to justify the FTT's decision.

58. The first related to the burden of proof. He pointed out that where costs are challenged under section 19 it is for the leaseholders to raise a prima facie case that the charge was not reasonably incurred; once they do so, the burden shifts to the landlord to show that it was. In the present case the landlord cannot do so because no-one can explain the cost incurred; Countryside cannot provide a breakdown between rental and maintenance. And market evidence indicates that the cost is far too high, even accepting Mr Allison's point that a new system would cost less to maintain than an old one.

59. The second related to the landlord's decision-making process: Mr Williams raised a purchase order without having had sight of the contracts. It was his decision to incur the cost regardless of any contractual obligation on the landlord's part. That was not a rational decision-making process.

60. The third related to the outcome of the landlord's decision to incur the cost. It is well-established that the term "reasonable" in section 19 means that the decision must not only be taken through a rational process but must also be objectively reasonable in outcome: *Waaler v Hounslow London Borough Council* [2017] EWCA Civ 45. The outcome of the decision in this case was not reasonable for the tenants because the price was far too high. The landlord's argument that section 19(1)(a) operates differently in the context of long-term agreements is wrong.

61. Finally Mr Spender sought to distinguish what was said in *Auger*. In that case, he said, the terms of the contact in question were controlled by the European-regulated tendering process that would precede it, which gave considerable protection to the tenants. Only in such a case would it be possible to say that the landlord could answer a challenge under section 19(1)(a) by the fact that it was contractually bound to make the payments. Likewise in *Lewisham v Rey-Ordieres* specific statutory protections were in place for the tenants. Mr Spender relied upon *Daejan v Benson and others* [2013] UKSC 14, another case about dispensation from the consultation requirements of section 20C of the 1985 Act. At paragraph 42 Lord Neuberger said:

> "It seems clear that sections 19 to 20ZA are directed towards ensuring that tenants of flats are not required (i) to pay for unnecessary services or services

which are provided to a defective standard, and (ii) to pay more than they should for services which are necessary and are provided to an acceptable standard. The former purpose is encapsulated in section 19(1)(b) and the latter in section 19(1)(a)

62. That, said Mr Spender, is the purpose of section 19(1)(a) in the present case, and insofar as the decisions in *Auger* and *Rey-Ordieres* might appear to run counter to that they have been superseded by what was said in *Daejan*. In the present case the leaseholders are getting necessary services, provided to an acceptable standard, but they are paying more than they should.

The Tribunal's determination about the Countryside contracts

63. Mr Spender's second point about the landlord's decision-making process and the role of Mr Williams can be disposed of briefly. Mr Williams is not the landlord. He was involved in day-to-day management, he had to activate the payment process by raising a purchase order, and he did not know the details of his employer's contractual arrangements. That is perfectly consistent with the landlord's case that it made the payments because it was bound by the contracts, because it was bound by the contracts whether or not Mr Williams knew that to be the case. Insofar as the FTT based its decision on Mr Williams' own decision-making process, it took into account an irrelevant matter; and the landlord's decision-making process cannot be attacked on the basis of the way in which Mr Williams carried out his duties.

64. I then turn to the decision in *Auger*. I disagree with what Mr Spender says about it; the Tribunal's reasoning did not depend upon the existence of special regimes to protect the tenants. On the contrary, the judge reasoned that the tenants would not be properly protected and therefore refused dispensation.

65. That decision could not be made today. *Auger* was decided in 2008, and since then the landscape regarding dispensation applications has changed; the Supreme Court's decision in *Daejan v Benson* means that dispensation can be refused only if the failure to consult caused prejudice to the leaseholders. It cannot be refused on the basis that the contract is a bad deal, unless the leaseholders could show that their observations would have led the landlord to make a different choice – which is not always, perhaps not even often, going to be the case. So the reasoning in paragraph 47 in *Auger* (quoted above at paragraph 46) could not now be a reason for refusing dispensation.

66. Is that reasoning in itself nevertheless correct, as the landlord argues, so as to provide an answer to what the leaseholders say in the present case?

67. What the leaseholders say – taking Mr Spender's other two arguments together – is that section 19(1)(a) is there to protect the leaseholders from paying too much for services, that therefore the decision to incur the costs in question must be one that is reasonable in terms of the outcome for the leaseholders, in the context of long-term agreements just as much as in other cases. The outcome of the incurring of the costs in the three years in dispute was not reasonable, because the charges were inexplicable and in any event far too high.

68. In addressing that argument I remind myself that the question I have to answer is whether the costs of the Countryside contracts were reasonably incurred by the landlords. The parties agreed that the relevant costs were incurred on the date when the invoices were

presented in the three years in dispute, relying upon *Burr v OM Property Management.* That is correct, but that does not mean that the FTT was able to make a judgment only about what happened at that point in time.

69. The issue in *Burr* was the need to decide when time starts to run for the purposes of section 20B of the 1985 Act, which provides that a tenant is not liable to pay service charges that reflect costs incurred more than 18 months before the demand for the relevant charges. Given the strict time-limit, there was a need to pin-point the date on which time started to run.

70. But section 19(1)(a) requires consideration of more than a pin-point in time, and of more than the options available to the landlord on that specific date.

71. That is always the case and is not a point limited to long-term contracts. At the point when an invoice is presented by a supplier the landlord will in most cases, and not just in the case of long-term agreements, already be contractually obliged to pay, and so will have no choice about incurring the costs on that date. It could of course choose not to pay, with consequences obviously bad for the tenants as well for the landlord, including the possibility of the services being disconnected, but the cost would still have been incurred when the invoice was presented and there was nothing the landlord could have done about that. That is likely to be the case for all contracts, whether short-term or long, unless the landlord pays in advance. In the present case Mr Spender suggested that the landlord could have sought to re-negotiate the contract, but could point to no basis on which the landlord could have had the bargaining power to do so and I regard the suggestion as fanciful.

72. So the moment of presentation of the invoice and the reasonableness of the landlord's making a payment in response to the invoice cannot be the only thing to be examined in connection with section 19(1)(a), because if it were then in all cases the answer would be as described in paragraph 47 in *Auger*; that the landlord was contractually bound to pay and therefore it was reasonable to incur the cost.

73. Instead, section 19(1)(a) is aimed at the incurring of costs in the broader sense of the landlord's taking on the liability; the mischief at which it aims is the landlord's committing to too high a price, and therefore the section requires an examination of the background to the presentation of the invoice. The question is whether it was reasonable – in the sense of producing a reasonable outcome for the landlord and the leaseholders as explained in *Waaler v London Borough of Hounslow* [2017] EWCA Civ 45 – for the landlord to have incurred the costs by entering a contractual commitment and thereby making itself liable to incur the costs, whether it did so a short while before invoicing in the case of a one-off contract or years before as in this case.

74. I think the approach of the FTT and the Tribunal to a challenge under section 19(1)(a) in respect of costs incurred under a contract should be to ask whether the cost was reasonably incurred in the sense that the landlord acted reasonably in taking on the commitment and thereby making it inevitable that it would incur the cost when the invoice was presented (whether that is going to happen once, or repeatedly throughout the contractual term). I therefore disagree with the analysis in paragraph 47 of *Auger*. Section 19(1)(a) is not disabled once a long-term contract is in place, or indeed by any other contract; it continues to operate just as does section 19(1)(b), so that under either sub-section a landlord may find itself bound by a contractual obligation but unable to recover the full costs from its

tenants, either because the service provided is sub-standard (s.19(1)(b)) or because the service is good but the price is unreasonably high (s.19(1)(a)).

75. The FTT was therefore right to look at what happened in 2000, and to ask whether it was reasonable for the developer/landlord to enter into the contracts with Countryside at that date, on the information then available.

76. The present situation is not analogous to the "historic neglect" situation, because the failure to do work in the past is not part of the incurring of the cost.

77. So far as the taking on of the contractual commitment in 2000 is concerned, that was of course not done by the present landlord; but for the reasons I have explained the appeal has to be approached on the basis that it is bound by those contracts. Section 19 of the 1985 Act requires that the cost be reasonably incurred, regardless of who incurred it. There has been some argument about whether the original leaseholders were aware of the rental agreements with Countryside when they purchased, and the FTT seems to have regarded that as problematic but I do not see the relevance of that. The issue is whether it has been shown that the contracts made in 2000 were, as the FTT called them, "a bad deal."

78. I agree with Mr Allison that in saying "the bad deal made in 2000 was still a bad deal in 2018" the FTT went beyond the evidence about the circumstances in 2000. There was no evidence whatsoever that the contract was a bad deal in 2000. Mr Spender did not suggest that. I have read the leaseholders' arguments in the FTT and there is no suggestion and no evidence that the developer could have done better in 2000. The challenge is only to the three years 2018, 2019 and 2020 and all the evidence relates to available prices for rental, purchase and maintenance at that date. The problem seems to be that the price of the relevant technology has gone down so much that the price set by the contract (even as modified by agreement in 2008) has become too high, but no-one could have foreseen that. Criticism of the deal in 2000 rests only on hindsight.

79. By the time the costs in 2018, 2019 and 2020 were actually incurred, when the invoices were presented, the landlord had no choice but to pay them; it had no choice because it was bound by contracts made in 2000 which it could not now escape, and the then landlord's decision to enter those contracts has not been shown to have been unreasonable (in the sense required by section 19(1)(a) as explained in *Waaler v Hounslow*).

80. Accordingly I take the view that the FTT's conclusion was not open to it on the evidence, not because it was wrong to look at the arrangements made in 2000 but because there was no evidence before it to justify the judgment that it made about those arrangements; its decision is set aside.

81. That being the case I do not need to say much about the FTT's supplementary decision on 3 May 2023 in which it adopted the leaseholders' suggestion as to what they should pay instead of the contract price. It is obviously problematic, because it means that the leaseholders have to pay what it would cost to maintain a relatively new system without having had to incur the cost of buying it. Had I needed to do so I would have set that decision aside on the basis that it was not a realistic or fair determination; but it is in any event set aside along with the FTT's initial decision, of which it was a consequence.

82. I substitute the Tribunal's own decision. The Tribunal accepts the landlord's concession of 25% of the cost in 2020, and determines that, with that concession, the costs of the Countryside contracts were payable in the years in dispute because they were reasonably incurred.

Costs

83. The FTT made an order in favour of the leaseholders under section 20C of the 1985 Act, preventing the landlord from recovering its costs of the litigation as a service charge (insofar as the lease permits that). The landlord wants that order to be reversed if it succeeds in its appeal from the decision about the Countryside contracts, on the basis that that was the most expensive item in issue in the FTT and it should therefore not be penalised by a section 20C order.

84. On the other hand, the leaseholders have indicated that they wish to make an application for a section 20C order in respect of the costs of this appeal, and for an order under rule 10(14) of the Tribunal's rules that the landlord reimburse the fees they have paid to the Tribunal. In accordance with Mr Spender's sensible suggestion I direct that within 28 days of the date of this decision the landlord may make written submissions as to why the section 20C order made by the FTT should be reversed, and as to why there should not be a section 20C order in respect of the costs of the appeal and an order in favour of the leaseholders under rule 10(14). If the landlord does so the leaseholders may reply within 21 days of receipt of those submissions. Any application for permission to appeal this decision, by either party, must be received by the Tribunal within one month of the Tribunal's determination of the applications in relation to section 20C and rule 10(14).

Upper Tribunal Judge Elizabeth Cooke

26 June 2024

Right of appeal

Any party has a right of appeal to the Court of Appeal on any point of law arising from this decision. The right of appeal may be exercised only with permission. An application for permission to appeal to the Court of Appeal must be sent or delivered to the Tribunal so that it is received within 1 month after the date on which this decision is sent to the parties (unless an application for costs is made within 14 days of the decision being sent to the parties, in which case an application for permission to appeal must be made within 1 month of the date on which the Tribunal's decision on costs is sent to the parties). An application for permission to appeal must identify the decision of the Tribunal to which it relates, identify the alleged error or errors of law in the decision, and state the result the party making the application is seeking. If the Tribunal refuses permission to appeal a further application may then be made to the Court of Appeal for permission.