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Case No: LC-2023-538

IN THE UPPER TRIBUNAL (LANDS CHAMBER)
ON APPEAL FROM THE FIRST-TIER TRIBUNAL (PROPERTY CHAMBER)
FTT Ref: LON/00BG/LVT/2022/0003

Royal Courts of Justice
23 January 2024

TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

LANDLORD AND TENANT – VARIATION OF LEASE – computation of a service charge in a lease – the construction of the "gateway" provisions of section 35(2) of the Landlord and Tenant Act 1987 – exercise of discretion – whether variation sought would be reasonable or would substantially prejudice the leaseholders

BETWEEN:

TOWER HAMLETS COMMUNITY HOUSING LIMITED

Appellant

-and-

LEASEHOLDERS OF PAINTER HOUSE

Respondents

Painter House,
Sidney Street,
London E1 2HU

Upper Tribunal Judge Elizabeth Cooke

Decision date: 9 February 2024

Mr Gary Cowen KC and Edward Blakeney for the appellant, instructed by Capsticks Solicitors
Mr Adam Swirsky for the respondents instructed on a direct access basis

Introduction

1. This appeal is brought with the permission of the First-tier Tribunal from its refusal of the appellant landlord's application, made pursuant to section 35 of the Landlord and Tenant Act 1987, for variations of the leases under which the respondents hold their flats in Painter House, Sidney Street, London E1. The names of the lessees who opposed the application and are respondents to the appeal are set out at the end of this decision

2. The appellant was represented in the appeal by Mr Gary Cowen KC and Mr Edward Blakeney, and the respondents by Mr Adam Swirsky; I am grateful to them all. Mr Blakeney also appeared before the FTT, and Mr Swirsky provided written submissions for the FTT hearing.

The legal background

3. It is perhaps surprising that there is a judicial power to vary leases, since the courts do not re-write people's bargains; but sometimes, either as a result of a drafting error or because the physical layout of a building or development has changed, it is in the interests of all concerned that there should be such a power. Section 35 of the Landlord and Tenant Act 1987 confers upon the FTT the power to vary leases in certain circumstances. The provision reads, as far as relevant:

> "(1) Any party to a long lease of a flat may make an application to [the FTT] for an order varying the lease in such manner as is specified in the application.
>
> (2) The grounds on which any such application may be made are that the lease fails to make satisfactory provision with respect to one or more of the following matters, namely—
> (a) the repair or maintenance of—
> (i) the flat in question, or
> (ii) the building containing the flat, or
> (iii) any land or building which is let to the tenant under the lease or in respect of which rights are conferred on him under it;
>
> (b) the insurance of the building containing the flat or of any such land or building as is mentioned in paragraph (a)(iii);
>
> (c) the repair or maintenance of any installations (whether they are in the same building as the flat or not) which are reasonably necessary to ensure that occupiers of the flat enjoy a reasonable standard of accommodation;
>
> (d) the provision or maintenance of any services which are reasonably necessary to ensure that occupiers of the flat enjoy a reasonable standard of accommodation …
>
> (e) the recovery by one party to the lease from another party to it of expenditure incurred or to be incurred by him, or on his behalf, for the benefit of that other party or of a number of persons who include that other party;
>
> (f) the computation of a service charge payable under the lease [;]

…

(4) For the purposes of subsection (2)(f) a lease fails to make satisfactory provision with respect to the computation of a service charge payable under it if—
(a) it provides for any such charge to be a proportion of expenditure incurred, or to be incurred, by or on behalf of the landlord or a superior landlord; and
(b) other tenants of the landlord are also liable under their leases to pay by way of service charges proportions of any such expenditure; and
(c) the aggregate of the amounts that would, in any particular case, be payable by reference to the proportions referred to in paragraphs (a) and (b) would [either exceed or be less than] the whole of any such expenditure.
…
(8) In this section *"service charge"* has the meaning given by section 18 of the 1985 Act.

4. I have set out sub-section (2) (a) to (f) so as to show the range of grounds on which an application may be made, but only (e) and (f) are relevant to this appeal. Sub-section (4) above sets out the circumstances in which ground (f) will apply, and it is agreed that these are the only circumstances where it applies – essentially where the lessees have to pay "a proportion" of the landlord's expenditure on services and the proportions together do not add up to 100%.

5. Section 38(1) provides that if any of the grounds in section 35(2) is established then the FTT may make an order varying the lease. In other words, the grounds in section 35(2) are gateways, and if the applicant passes through one of them then the FTT has a discretion to vary the lease. It may make the amendment requested by the applicant or such other variation as it thinks fit (s. 38(4)). If it makes a variation the FTT may order the applicant to pay compensation to any party to the lease or to any other person in respect of any loss or damage they are likely to suffer as a result of the variation. But section 38(6) provides:

> "(6) [The FTT] shall not make an order under this section effecting any variation of a lease if it appears to [the FTT] —
> (a) that the variation would be likely substantially to prejudice—
> (i) any respondent to the application, or
> (ii) any person who is not a party to the application,
> and that an award under subsection (10) would not afford him adequate compensation, or
> (b) that for any other reason it would not be reasonable in the circumstances for the variation to be effected.

The factual background and the leases

Painter House, Peter House and the Commercial Unit

6. Painter House is a block of 24 flats. Peter House is a block of 14 flats, adjacent to Painter House so that the two look like a single building; but they have separate entrances and neither is accessible from inside the other. The flats in Painter House occupy the first to fifth floors, and those in Peter House the first to fourth floors; on the ground floor spanning both blocks is an office unit ("the Commercial Unit"), occupied by the appellant itself, Tower Hamlets Community Housing Limited. The appellant owns the freehold of the whole

building, which is a single registered title comprising Painter House, Peter House, a little garden at the back, an outbuilding and some parking spaces. The footprint of the Commercial Unit is considerably larger than the floor area of the flats above it, but the Tribunal was not given any measurements so I cannot say how much larger its footprint is. Necessarily therefore part of the Commercial Unit has a flat roof.

7. It is important to say at the outset that the parties agree that the terms "Painter House" and "Peter House" refer to a block that includes the ground floor, being the eastern half of the Commercial Unit in the case of Painter House and the western half in the case of Peter House. The Commercial Unit is not divided internally into two halves, and we have to imagine a vertical division below the division between the two sets of flats. The FTT also used the terms "Painter House" and "Peter House" in that way, and I therefore do so too, although (because the parties agree on this point) I have heard no argument about that construction of the leases.

8. Of the 14 flats in Peter House, 13 are held on short-term tenancies and one (flat 14) is held on a long lease. There is no application to vary the lease of flat 14; I shall have to come back to it later since its terms were referred to in argument.

9. The appeal is about Painter House, where all 24 flats are held on long leases, most granted in 2007. The leases of 22 of the flats other than numbers 9 and 11 are in identical terms in all material respects (save that the numbering has gone awry in Flat 4; there is no application to vary that numbering). In the paragraphs below I set out and comment on the provisions relevant to the payment of service charges, copied from one of the 22 identical leases, and I then comment on the different provisions in the leases of flats 9 and 11.

10. The 22 identical leases say this:

> "Local Authority District : London Borough of Tower Hamlets
> Title Number(s) : EGL482597
> Property : Plot 27 (Flat 14) Painter House Sidney Street London E1 2HU
>
> PARTICULARS AND DEFINITIONS
>
> …
>
> Estate : The land and the premises situate within the land as shown registered under the title number above
> Block : Painter House Sidney Street London E1 2HU
> Premises : Plot 27 on the 3rd floor of the Block as shown edged red on the Plan and includes the fixtures …
> Specified Proportion of Service Provision : 1/38th"
>
> …
>
> 1(2)…
>
> (b) "the Common Parts" means the lifts hallways entrances landings staircases balconies (save and excepting any exclusively serving any flat within the Block) dustbin enclosure boundary walls or fences and other parts of the Estate and any access areas steps pedestrian ways footpaths or accessway communal play and/or garden areas and car parking spaces (other than those demised) and the forecourts of the Estate and any other areas or facilities in the Block which are

used or intended for use by the Leaseholders of the flats within the Block together with the Tenants of the Estate"

11. It follows from what has been said above, and from the definition of "the Block" in the leases, that "the Block" in the case of Painter House includes the eastern half of the Commercial Unit on the ground floor. As for "the Common Parts", the FTT found that they do not include any part of the Commercial Unit; there is no appeal from that finding (nor do I think that any such appeal could succeed, since the definition refers to areas intended for use by the leaseholders of the Block).

12. The Leaseholder's covenants are at clauses 3 and 4 and include a covenant to pay the Service Charge in accordance with clause 7.

13. The Landlord's covenants are at clause 5 and include the following obligations:

> "5(2) That the landlord will at all times during the term … keep or procure to keep the Block insured against loss or damage by fire and other such risks as the landlord shall from time to time reasonably determine…
>
> 5(3) That (subject to payment of the Specified Rent and Service Charge and except to such extent as the Leaseholder or the tenant of any other part of the Block shall be liable in respect thereof respectively under the terms of this Lease or of any other lease) the Landlord shall maintain repair redecorate and renew (or procure the maintenance repair redecoration and renewal of): -
>
> (a) The roof foundations balconies patio areas (if any) and main structure of the Block and all external parts thereof including all external and load-bearing walls with the windows and doors of the outside of the flats within the Block (save the glass in such doors and windows and the interior surface of the walls) and all parts of the Block which are not the responsibility of the Leaseholder under this Lease or any other Leaseholder under a similar lease or other premises in the Block (including for the avoidance of doubt) the Common Parts of the Block and the Estate …
>
> (b) the pipes sewers drains wires cisterns and tanks and other gas electrical drainage ventilation and water apparatus and machinery in under and upon the Block (except such as serve exclusively an individual flat in the Block and except such as belong to British Telecom or any public utility supply authority)
>
> (c) the Common Parts of the Block and the Estate
>
> 5(4) That … so far as practicable the Landlord will keep or procure that the Common Parts are adequately cleaned and lighted…
>
> 5(5) That every lease or tenancy of premises in the Block hereby granted by the Landlord shall contain covenants to be observed by the tenant thereof similar to those set out in the First Schedule hereto and (save in the case of any premises which may be let at full or fair rents) shall be substantially in the same form as this Lease".

14. The service charge provisions are at clause 7 and include:

> 7(1) In this Clause the following expressions have the following meanings -
> …
> (b) "Specified Proportion" means the proportion as specified in the Particulars
> (c) "the Service Provision" means the sum computed in accordance with subclauses (4), (5) and (6) of this clause
> (d) "the Service Charge" means the Specified Proportion of the Service Provision…
>
> (2) the Leaseholder HEREBY COVENANTS with the landlord to pay the Service Charge…
>
> (4) The Service Provision shall consist of a sum comprising –
>
> (a) the expenditure estimated by the Surveyor as likely to be incurred in the Account Year by the Landlord up on the matters specified in Clause 7(5) together with
> (b) an appropriate amount as a reserve for or towards such of the matter specified in Clause 7(5) as are likely to give rise to expenditure after such Account Year … but
> (c) reduced by any unexpended reserve already made pursuant to sub-clause (b) in respect of any such expenditure as aforesaid.
>
> (5) The relevant expenditure to be included in the Service Provision shall comprise all expenditure reasonably incurred by the Landlord in connection with the repair management maintenance and provision of services for the Building and shall include (without prejudice to the generality of the foregoing)-
>
> (a) the costs of and incidental to the performance of the Landlord's covenants contained in Clauses 5(2) and 5(3) and 5(4)
> (b) the costs of and incidental to compliance by Landlord with every notice regulation or order of any competent local or other authority in respect of the Building (which shall include compliance with all relevant statutory requirements)
> (c) all reasonable fees charges and expenses payable to the Surveyor any solicitor accountant surveyor valuer architect or other person whom the Landlord may from time to time reasonably employ in connection with the management or maintenance of the Building including the computation and collection of rent (but not including fees charges or expenses in connection with the effecting of any letting or sale of any premises) including the cost of preparation or the amount of the Service Charge and if any such work shall be undertaken by an employee of the Landlord then a reasonable allowance for the Landlord for such work
> (d) any rates taxes duties assessments charges impositions and outgoings whatsoever whether parliamentary parochial or local or of any other description assessed charged imposed or payable on or in respect of the whole of the Building or in the whole of any part of the common Parts
> (e) any administrative charges incurred by or on behalf of the Landlord including but not limited to:

(i) the grant of approvals under this Lease or applications for such approvals
(ii) the provision of information or documents by or on behalf of the Landlord
(iii) costs arising from non-payment of a sum due ot the Landlord and/or
(iv) costs arising in connection with a breach (or alleged breach) of the Lease

(f) description assessed charged or imposed or payable on or in respect of the whole of the Building or in the whole or any part of the Common Parts

(7) The Landlord will for the period that any premises in the Building are not let on terms making the tenant liable to pay a Service Charge corresponding to the Service Charge payable under the Lease provided in respect of such premises a sum equal to the total that would be payable by the tenants thereof as aforesaid by way of contribution to the reserve referred to in Clause (7)(4)(b) and the said reserve shall be calculated accordingly
(8) For the avoidance of doubt it is hereby agreed and declared that the provisions of Section 18 to 30 of the Landlord and Tenant Act 1985 as amended shall apply to the provisions thereof".

15. It will be seen that these 22 lessees are required by their leases to pay 1/38 of the service charge, comprising the landlord's expenditure listed in clause 7(5). That list comprises first, at 7(5)(a), the cost of the landlord's complying with its covenants in clause 5 (2), (3) and (4), which refer to the insurance, maintenance, repair and decoration of the Block and of the Common Parts of the Block and of the Estate. The remaining items on the list, at 7(5)(b) to (f), refer to expenditure on the Building and on the Common Parts. The term "Building" is not defined in the leases; the parties agree that it should be amended to read "Block" and the FTT made an order to that effect by consent, so I will construe the leases on the basis that that is what they say.

16. The remaining two leases in Painter House, of flats 9 and 11, are exactly the same except that the lessee is required to pay "a fair proportion" of the service charge. The definitions at the front of these two leases are puzzling, in that the "Estate" is defined as the flat and the "Block" as the whole estate, but it looks as if the two definitions have been transposed. There is no application to vary those muddled definitions.

17. From what has been said so far, it will be seen that the residents in the flats with the 22 identical leases are each required to pay 1/38 of a service charge calculated by reference to the landlord's expenditure on Painter House. The lessees of flats 9 and 11 have to pay "a fair proportion" of the same. The effect of the various definitions is that that expenditure comprises the costs of insurance, maintenance, repair and decoration both of the residential flats in Painter House and also the eastern half of the Commercial Unit. It also includes costs relating to the Common Parts both of the Block and of the Estate (the latter perhaps referring to the garden and other land at the back of the Block, but I heard no argument about what "the Common Parts of the Estate" are).

The proceedings in the FTT

18. The appellant asked the FTT to amend all 24 Painter House leases by:

    a. Changing "Building" to "Block" in clause 7;

    b. Defining the "Specified Proportion of Service Provision" to read:

        i. 1/24 rather than 1/38 in respect of costs incurred in maintaining the Block and

        ii. 1/38 in respect of costs incurred in maintaining the Estate (other than the Block);

        iii. Alternatively, varying the Specified Proportion to read "such reasonable proportion of the Total Expenditure as the Lessors shall state is attributable to the Demised Premises".

19. The appellant's Statement of Case in the FTT made no mention of the Commercial Unit. Reading that document without background knowledge one could only conclude that Painter House is a block of 24 flats and that the problem is that only 24/38 of the landlord's expenditure on that block of 24 flats is recoverable.

20. The appellant's Statement of Case at paragraph 15 asked for the variation to be back-dated so that its historical charging practice would match the terms of the leases.

21. A number of the Painter House lessees opposed the application and filed a joint Statement of Case which stated at its outset that "Painter House" or "the Block" comprised 24 flats on floors 1–5 and the eastern half of Commercial Unit on the ground floor occupied by the landlord. They were content for the word "Building" to be changed to "Block", but they resisted any other change to their leases. They argued that the service charge arrangements might well have been deliberate (aside from the inconsistency between flats 9 and 11 and the rest); the proportions as set out ensure that the landlord is liable for 14/38 of its expenditure on the Block, so that in effect it pays the costs attributable to the ground floor. Insofar as that was found not to be the case they asked for expert evidence to be called so as to ascertain the correct apportionment of services between the ground floor and the rest of the Block.

22. The lessees also complained that they were already being charged for some services consumed by the Commercial Unit, and regarded the proposed variation as an attempt to reinforce an already unfair system. They also argued that compensation would be payable if a variation was ordered.

23. The appellant's response to the lessees, in the FTT, said:

> "11.1.3 It is appropriate for service charge contributions in the leases in the Block to total 100% of the relevant expenditure, particularly where THCH is a community benefit society."

24. However, the appellant's reply also said that the Commercial Unit was billed separately for certain services (electricity and gas are separately metered, fire alarms and fire risk assessments were separately billed) and that insurance was apportioned between the Commercial Unit and the residential lessees, and that the cost of major works "would potentially be shared" between all those in the Block and in Peter House, depending on the

scope of works. The appellant called evidence about the way that water charges had been apportioned. The cost of utilities is of course not one of the items of expenditure set out in clause 7(5) of the lease so the arrangements made for gas, electricity and water were of questionable relevance.

25. The FTT agreed that the term "Building" should be replaced by "Block". Otherwise it rejected the appellant's application. It said this:

> "117. At first sight, the applicant's case appears attractive. There are 38 flats in Painter and Peter Houses, the original intention was for each flat to be pay an equal 1/38th contribution to "the Service Provision" and there was an error in the drafting of the leases. However, this does not take account of the substantial Commercial Unit, used as the applicant's head office. Based on the Tribunal members' knowledge and long experience, gained from hearing numerous service charge cases, it is common for service charges to be apportioned between residential and commercial units on mixed-use properties. …
>
> 119. Turning now to s.35(2), the applicant contends the service charge proportions do not add up to 100% as twenty-two flats pay 1/38th and the other two pay "A fair proportion". The Tribunal accepts the Commercial Unit must be disregarded when calculating the total proportions, as submitted by Mr Blakeney. Section 35(4) refers to "a lease" and "leases" and there is no lease of the Commercial Unit.
>
> 120. Where the Tribunal differs from Mr Blakeney is on the meaning of "service charge proportions" at s.35(4)(b). Logically, this must refer to fixed proportions, expressed as a fraction or percentage, otherwise it is impossible to compute a total. Descriptive proportions that can vary over time, such as fair or reasonable, are not compatible with this section or s.35(2)(f). In this case, Flats 9 and 11 each pay "A fair proportion". The Tribunal is not determining what a fair proportion means, has not heard from the leaseholders of Flats 9 and 11 and has no details for their flats. Whilst a total of 16/38ths is unlikely to be fair, the Tribunal cannot determine this issue.
>
> 121. The Tribunal agrees with Mr Swirsky, who drafted the collective response. The applicant cannot rely on s.35(2)(f). Not all the leases express a proportion within the meaning s.35(4). If the Tribunal is wrong about this, it still would not vary the leases as the current service charge provisions are perfectly workable and satisfactory (see paragraph 126, below).
>
> 122. Section 35(2)(e) is much broader than s.35(2)(f). The applicant contends the leases fail to make satisfactory provision for the recovery of service charges in two respects:
>
> (a) clauses 7(4), (5) and (7) incorrectly refer to the "Building" rather than "Block", and
>
> (b) it can only recover 24/38ths (or 22/38ths and two fair proportions) of the service charge costs at Painter House.

> 123. The applicant succeeds on the first ground, as the use of "Building" is a clear defect. The variation is necessary to cure this defect and should be backdated to the respective dates on which the leases were granted. Compensation does not arise, as the variation benefits all parties and there is no prejudice, let alone substantial prejudice, to the respondents.
>
> 124. The second ground is less clear-cut. [The FTT discussed and rejected some of the lessees' arguments]…
>
> 126. Having said that, the Tribunal accepts the underlying principle that 1/38th proportions are satisfactory when you take account of the Commercial Unit. The current service charge provisions are perfectly workable, as the applicant can recover 24/38ths (or 22/38ths and two fair proportions) of the Painter House costs from the respondents. This is well over half. The applicant must fund the shortfall, but this is satisfactory as it occupies the substantial Commercial Unit and derives considerable benefit from the communal services (insurance, maintenance, management, repairs etcetera).
>
> …
>
> 128. The applicant has not established the gateway ground at s.35(2)(e), in relation to the service charge proportions. It is therefore unnecessary for the Tribunal to decide whether to vary the leases and, if so, whether to backdate and/or award compensation."

26. Nevertheless, the FTT made an order changing the word "Building" to "Block" in all the Painter House leases. It made no order on the lessees' application for an order under section 20C of the Landlord and Tenant Act 1985 on the basis of the appellant's confirmation that it would not seek to recover its costs of the proceedings from the lessees.

27. The appellant sought permission to appeal on seven grounds, and the FTT gave permission on five of those grounds.

The appeal

28. The appellant advances 7 grounds of appeal; it seeks permission to appeal on grounds 2 and 3, and has permission from the FTT on the rest. As will be seen, the important one is ground 1 and I shall be able to deal briefly with the rest.

Ground 1: the FTT misconstrued section 35(4)(b)

29. It will be recalled that the "gateway" at section 35(2)(f) is that the lease fails to make satisfactory provision with respect to the computation of the service charge, and that the lease meets that description only if:

> "35(4)…
>
> (a) it provides for any such charge to be a proportion of expenditure incurred, or to be incurred, by or on behalf of the landlord or a superior landlord; and

(b) other tenants of the landlord are also liable under their leases to pay by way of service charges proportions of any such expenditure; and
(c) the aggregate of the amounts that would, in any particular case, be payable by reference to the proportions referred to in paragraphs (a) and (b) would [either exceed or be less than] the whole of any such expenditure."

30. It is worth pausing over that wording to notice that the provision is binary. Either the proportions payable by the tenants add up to more or less than the "expenditure incurred", or they do not. Nothing is said about that expenditure, and in particular the sub-section does not say that the expenditure must be incurred solely for the benefit of the lessees. An example discussed at the hearing is a block comprising ten flats. Assume that each flat is the same size and consumes about 1/10 of the landlord's expenditure in insuring, repairing, maintaining and decorating the block. If all ten are let, the service charge is defined as the landlord's expenditure on the block, and each flat pays 10%, then the condition is section 35(2)(f) is not met. But if the ground floor flat is not let and is the landlord's home, the service charge is defined as the landlord's expenditure on the block, and each of the nine leased flats pays 10% then the condition is met – even though in such a case it is hard to imagine any reason why a variation should be made. So the gateway at section 35(2)(f) is rather a blunt instrument; getting through the gateway does not necessarily entail a successful application for variation. I apologise for labouring that example but it is going to be useful later.

31. The first ground of appeal is that the FTT was wrong to decide (at its paragraph 120, quoted above) that "proportions" in section 35(4)(b) means only numerical proportions, and that the requirement cannot be met if any of the leases has to pay a descriptve proportion, as do flats 9 and 11 which have to pay "a fair proportion". The FTT took the view that for this provision to apply it must be possible to compute a total, which of course it could not do.

32. Mr Cowen KC argued that the FTT was wrong about this. Even though the proportion payable by flats 9 and 11 cannot be computed, it is obvious, he argued, that 16/38 shared between the two flats would not be fair, and that therefore the requirements of the subsection were met. He pointed out that there is no policy reason for excluding proportions expressed as descriptions rather than as numbers. He gave the example of a block of 10 flats where 9 of the flats have leases that provide for payment of 12% of the service charge and the other provides for the payment of a reasonable proportion of the service charge. Notwithstanding that those provisions together mean that there would be an over-recovery of service charge, on the FTT's construction of the 1987 Act there is no jurisdiction to vary the leases.

33. At the hearing Mr Swirsky did not press his opposition to this obviously correct argument. The appeal succeeds on this ground; the FTT misconstrued section 35(4) and therefore came to the wrong conclusion about section 35(2)(f).

34. It is not in dispute that the consequence of that is that the circumstances meet the condition set out in section 35(2)(f), so that the FTT then had a discretion whether to vary the lease.

Ground 2: the "fair proportion" contributions

35. This is one of the grounds on which the FTT refused permission. The point is that the FTT said it could not determine what was a "fair proportion" for flats 9 and 11, but that was not what it was asked to do. What it should have done, says the appellant, was to determine that 16/38 shared between these two flats could not possibly be fair. That is obviously correct

and has already been dealt with; permission is granted and the appellant succeeds on this ground.

Grounds 3: relevant considerations

36. Ground 3 attacked some aspects of the reasoning in the FTT's decision. Mr Cowen KC agreed that ground 3 by itself would not get the appellant home. As grounds 1 and 2 have succeeded there is no point in granting permission on this ground; equally there would have been no point had grounds 1 and 2 failed. Permission on this ground is refused.

Ground 4: what is a "satisfactory" service charge provision

37. At paragraph 121 of its decision the FTT said that even had the condition in section 35(2)(f) been met it would not have exercised its discretion to vary the leases because the current provisions were "perfectly workable and satisfactory". It said that because it took the view that the current arrangement has the landlord – being in occupation of the Commercial Unit – paying 14/38 of the cost of services to the Block. The FTT was aware that the Commercial Unit has a much bigger footprint than the rest of the Block. It took the view that 14/38 was a satisfactory apportionment for the Commercial Unit.

38. The appellant says that this is wrong. Having left the Commercial Unit out of account in considering whether the section 35(2)(f) gateway was passed it should equally have left it out of account in considering whether to vary the leases.

39. This is obviously not correct. If we go back to the example in paragraph 30 above, it will be seen that where there are 9 leases each paying 10% of the costs, and the landlord is living in the 10th flat, the gateway is passed but there is no reason to vary the leases. The consequence of the appellant's argument on ground 4 is that the leases in that case should be varied, which (in view of the way in which I have set up the example, with equal size and consumption rates for each flat) is clearly wrong. In the unlikely event that an application for variation were made in such a case there would have to be careful consideration of the reasons why the leases should be varied, and that would certainly include the extent of expenditure incurred for the benefit of the landlord's flat.

40. Ground 4 fails.

Grounds 5, 6 and 7

41. Ground 5 is simply that because the gateway in section 35(2)(f) was passed, the variation applied for should be made. That is, as already noted, a large question; passing the gateway does not mean automatic variation. Insofar as the appellant sought to argue that it does, the ground fails, but of course since grounds 1 and 2 succeed I have to come back to this.

42. Ground 6 is that for the same reason there should be a variation pursuant to section 35(2)(e). The appellant argued that the condition in section 35(2)(e) was satisfied for the same reason as the condition in section 35(2)(f) was satisfied, namely that the lease fails to make satisfactory provision for:

> "(e) the recovery by one party to the lease from another party to it of expenditure incurred or to be incurred by him, or on his behalf, for the benefit of that other party or of a number of persons who include that other party".

43. That does not follow at all. The example in paragraph 30 again demonstrates the problem; where there are 9 lessees, each paying 10% of the whole expenditure, leaving the landlord to pick up the other 10%, and the size and consumption of the flats are equal, the condition in section 35(2)(f) is met but the condition in section 35(2)(e) is not.

44. In the present case the FTT held that the appellant did not get through the gateway in section 35(2)(e) because it took the view that the service charge provisions were "perfectly workable and satisfactory". I might not be quite so optimistic, but in the circumstances I do not regard that as an irrational conclusion for the FTT to have reached. It was an evaluative decision, and on the basis of the evidence before it – particularly where the appellant had made no attempt to produce evidence as to what proportion of the expenditure on the Block was in fact for the benefit of the Commercial Unit – there is no reason for the Tribunal to interfere. The appeal fails on this ground.

45. Ground 7 is that having reached the wrong conclusion on the gateway provisions in section 35(2) the FTT failed to go onto section 38 and consider whether the service charge proportions in the leases should be varied as the landlord sought. In light of what I have said about grounds 1 and 2 this ground succeeds.

Disposal: the Tribunal's substituted decision

46. The condition in section 35(2)(f) was met, and therefore the FTT had a discretion to vary the service charge proportions in the lease and should therefore have decided whether or not to do so. Both parties at the hearing agreed that if I reached that conclusion I should substitute the Tribunal's decision and exercise the statutory discretion, rather than remitting the matter to the FTT, and I shall do so.

47. It is worth pointing out that the FTT did make a variation, by consent, by changing the word "Building" to "Block" in all the leases; it said nothing about why it had jurisdiction to do so. For the avoidance of doubt I therefore confirm that variation (having explained above why the Tribunal has jurisdiction to vary the leases, on the basis of section 35(2)(f)). The parties' solicitors will need to ensure that the requisite entry is made by HM Land Registry on all the relevant titles to reflect that change.

48. That leaves the much more significant change that the appellant seeks, namely to change all the service charge proportions to 1/24 (instead of 1/38 or "a fair proportion") so far as expenditure on the Block is concerned and to 1/38 so far as expenditure on the Estate is concerned. So far as I can see the only way in which the lessees are required to contribute to the Estate rather than the Block is where reference is made to the Common Parts of the Estate; quite what would be the effect of the change to 1/38 of expenditure on the Estate has not been explained.

49. But the important point is that the appellant wants to vary the residential leases so that the lessees are required to pay 1/24 of the landlord's expenditure on the Block including the ground floor.

50. Mr Cowen KC explained that historically the appellant has charged the lessees only for those services that benefit them; it has not charged the residential lessees for the insurance of the Commercial Unit nor for anything else that benefits the Commercial Unit alone. It proposes to continue that practice, despite that not being the effect of the variations for which it applied to the FTT. In other words it proposed to make the lessees liable together

for the whole of its costs in insuring, repairing, maintaining and decorating (etc) the block, but not actually to enforce that liability in practice. Mr Cowen KC explained that the applicant took the view that that was the simplest way, doing least violence to the drafting of the leases, to achieve what it wanted.

51. Section 38 of the 1987 Act states that the FTT must not order a variation if it appears:

> "(a) that the variation would be likely substantially to prejudice—
> (i) any respondent to the application, or
> (ii) any person who is not a party to the application,
> and that an award under subsection (10) would not afford him adequate compensation, or
> (b) that for any other reason it would not be reasonable in the circumstances for the variation to be effected".

52. The Tribunal cannot order a variation in respect of which either (a) or (b) is met. No reassurance that the landlord does not really mean it and will not demand service charges that would substantially prejudice the respondent can enable the Tribunal to make such a variation. In any event such a reassurance could not take away the prejudice or make an unreasonable arrangement reasonable. Even if the residents were confident that the appellant would keep that promise they would be unable to persuade a purchaser to take the same view. Their leases would be devalued if not unsaleable. And how would such a promise be enforced if the appellant were to sell the freehold?

53. Therefore the Tribunal has to look at the variation sought on the basis that the appellant means what it says and wants the residential leases to be varied so that the 24 leases pick up the whole cost of the landlord's expenditure on services for the Block, defined as agreed to include the eastern half of the Commercial Unit.

54. The respondents' position, Mr Swirsky explained, is that they are perfectly content to reimburse expenditure incurred for their benefit but they object to meeting these costs for their landlord – or indeed for a third party if the appellant should decide to let the Commercial Unit in future.

55. The appellant's arguments in favour of the variation it sought before the FTT are as follows.

56. First, it is said that this is what the original parties intended. The drafting of the leases, which identify the demised premises by reference to plot numbers rather than to flat numbers, indicates that originally there was no intention to separate the property into two blocks; the idea was to have 38 flats and have the service charge divided equally between them, but when it was decided to divide the property into two blocks the drafting did not catch up.

57. I agree that the most likely explanation for the division into thirty-eighths is that there are thirty-eight flats altogether (rather than any conscious decision to make the occupant of the eastern half of the Commercial Unit responsible for 14/38 of the whole); but I do not understand why it might be supposed that the original residential lessees actually intended to pay for the landlord's expenditure on the Commercial Unit as well as on the residential part of the Block. Be that as it may, that is not what the leases as executed provide, and the question is whether it would substantially prejudice the respondents, or would for any other

reason not be reasonable in the circumstances, if the variation sought by the appellant were made.

58. Second, it is said that if the Tribunal refuses to make the variation proposed that will generate inconsistency with the position of the single long lease in Peter House, which the appellant says is responsible for a proportion of the expenditure on the whole Peter House Block including the ground floor. I was not given any coherent explanation of what is actually charged to the lessee of Peter House; in any event if the lessee of flat 14 Peter House is in fact responsible for part of the costs of the Commercial Unit, that is not a reason for imposing such an arrangement on 24 other flats.

59. Third, it is said that where the original parties to the lease intended the landlord to make a contribution to the services they made specific provision to that effect in clause 7(7) (see paragraph 14 above where the lease requires the landlord to contribute where any of the flats is not let on terms that make provision for payment of the service charge). That is a technical drafting point and it does not provide a reason why the parties should have intended the residential lessees to be responsible for the landlord's expenditure on the Commercial Unit.

60. Finally, it is said that the appellant puts its profits back into its housing projects; it is a registered provider of social housing with approximately 2,000 rented units and 1,000 long leasehold units. Mr Cowen KC in his skeleton argument said that there is therefore "a rational basis for A ensuring its costs are met entirely from leaseholders as that supports its charitable objects." How that is consistent with the assurance that the appellant does not actually intend to charge to the residential flats the costs of insuring and maintaining (etc) the Comercial Unit is a mystery.

61. The appellant is running a business and of course has to cover its costs. But why the costs of maintaining its office should be the responsibility of this small group of tenants, rather than being funded by its overall income from a few thousand lessees, is not explained and cannot be justified.

62. The variation sought by the appellant would make the residential lessees of Painter House responsible for the whole of the landlord's expenditure (as defined in clause 7(5) of the leases) on the ground floor offices. That would be a bizarre arrangement. One can imagine the estate agent's particulars should the appellant choose in future to let the Commercial Unit: "No service charge, the flats above pay for everything!"; and one can imagine the effect of that arrangement upon the rent that the appellant might charge.

63. To amend the leases as the appellant sought in its application would substantially prejudice the respondents and would be unreasonable, and I decline to do so.

64. At the hearing the appellant put forward an alternative case, namely that "Painter House" be defined in the leases to mean floors 1 to 5 plus the Common Parts, the roof and the foundations. Mr Swirsky was understandably unable to take instructions on that proposal since not all his clients were present. But he pointed out that it left too many questions unanswered. There is no information from the appellant as to where the service installations are – where is the air conditioning, for example? Why would the lessees be responsible for the roof and foundations, when the Commercial Unit benefits from them? I would add that merely re-arranging the definition of Painter House does not work, because whilst the lessees would then be responsible only for the cost of insuring floors 1 to 5, they still need a covenant from the landlord to insure the whole block including the ground floor.

65. Mr Cowen KC suggested that if I were minded to make the variation now proposed in the alternative I should allow the appellant a week to consider any consequential amendments or unforeseen problems. In my judgment it would be unfair to the respondents to give the appellant the opportunity to do now the work that it should have done before making the application to the FTT. I decline to make the alternative variation now proposed.

66. I said above that I was not quite so optimistic as the FTT in regarding the present arrangement as satisfactory. It would be an odd coincidence if the eastern half of the Commercial Unit really does consume 14/38 of the appellant's expenditure on the Block. I think it more likely that, as the appellant suggested, the figure of 38 comes from there being 38 flats, but that the drafter overlooked the existence of the Commercial Unit (which is not mentioned in the leases), and originally assumed a block of 38 flats and nothing else, with each flat contributing 1/38. That is speculation. What is perfectly obvious is that something has gone wrong.

67. The leases ought to contain a rational apportionment between the residential part of the Block and the Commercial Unit. It may be that that is better achieved by adjusting the proportions rather than by carving the building up by description. Perhaps it is not fanciful to hope that the lessees and the appellant could work together to come up with something mutually acceptable.

Conclusion

68. The appeal fails, because although the appellant is right about the construction of section 35(2)(f) the Tribunal declines to exercise its discretion to vary the residential leases. The outcome remains as decided by the FTT and no variation is made.

Upper Tribunal Judge Elizabeth Cooke

9 February 2024

Schedule of respondents

(1) EMMANUEL & YVETTE LINGOM
(2) MIRIAM TECLE
(3) BRETT NOBLE & CHRIS MCNAMARA
(4) JOSEPH DONOVAN
(5) ANJA STOSIC
(6) JORGE TSENG
(7) OLADIPO ODUNSI
(8) MATTHEW BARBER
(9) TAFUZZAL MIAH
(10) MOHAMMED & NADINE BASIT
(11) BETH SPENCER (12) FATMA & SHAHEEN JOGIAT
(13) CYNTHIA KENG JU QUEK
(14) ELSA-JON GERALDINE CARDOZA
(15) PETER MENGERINK (16) CYPRIAN CROWLEY

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.