UPPER TRIBUNAL (LANDS CHAMBER)

TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

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LANDLORD AND TENANT – SERVICE CHARGES – on account service charges – whether amounts claimed were reasonable – appeal dismissed

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

BETWEEN:

JONATHAN BRETT
MARIA BRETT

Appellants

-and-

HARLOW COURT LIMITED

Respondent

Re: 14 Harlow Court,
Wray Common Road,
Reigate

Martin Rodger, Deputy Chamber President

26 January 2022

Royal Courts of Justice

The first appellant represented himself and the second appellant.
Simon Arnold, instructed by Browne Jacobson, appeared for the respondent

The following cases are referred to in this decision:

Eshraghi v 7-9 Avenue Road (London House) Limited [2020] UKUT 208 (LC)

Avon Ground Rents v Cowley [2018] UKUT 92 (LC)

Avon Ground Rent Limited v Cowley [2019] EWCA Civ 1827

Knapper v Francis [2017] UKUT 3 (LC)

Introduction

1. The factual background to this appeal from a decision of the First-tier Tribunal (Property Chamber) (the FTT) is complicated, but the question which the FTT had to determine was relatively straightforward. It was whether interim service charges levied by the respondent landlord and paid by the appellant leaseholders were reasonable amounts having regard to overpayments of service charges in previous years. The FTT decided that, in the circumstances of the case, it was not necessary for the respondent to set the overpayments off against its anticipated expenditure in the forthcoming year before determining the reasonable amount to be demanded in advance as a contribution towards that expenditure. The appellants now appeal against that decision.

2. The appellants are Mr and Mrs Brett, who were formerly the owners of the long lease of a flat at Harlow Court in Reigate in which they first acquired an interest in January 2011. Harlow Court is a block of 18 flats all of which are let on long leases.

3. In 2013 the respondent, Harlow Court Ltd, was established by the leaseholders of the flats in the building with a view to acquiring the freehold, which it did in June that year.

4. Mr Brett, the first appellant, was originally a director of the respondent but in 2016 he resigned after a disagreement over the way in which the service charge accounts and the company's own accounts were being kept.

5. The FTT gave its decision on 1 June 2021 and permission to appeal was subsequently granted by this Tribunal.

6. The amount of a service charge which a tenant can be required to pay in advance towards anticipated future expenditure is limited by section 19(2) Landlord and Tenant Act 1985, which provides that:

> "Where a service charge is payable before the relevant costs are incurred, no greater amount than is reasonable is so payable, and after the relevant costs have been incurred any necessary adjustment shall be made by repayment, reduction or subsequent charges or otherwise."

The leases

7. On 17 March 2014 the respondent granted the appellants a new lease of their flat for an extended term of 999 years. Leases in the same form were also granted to the leaseholders of the other flats in Harlow Court.

8. Under their original lease, the terms of which were replicated in their new lease, the appellants were required to pay a Maintenance Charge equal to $1/18^{th}$ (5.56%) of the Annual Cost incurred by the Lessor. The Annual Cost was defined in clause 3(2)(ii) as the expenditure "incurred or to be incurred" by the Lessor in carrying out its obligations in the

lease in any Accounting Period or as a "forward payment" towards any large item of expenditure to be incurred in a subsequent Accounting Period.

9. By clause 3(2)(b) the appellants were to pay in advance and on account of the Maintenance Charge an amount specified by the respondent's surveyor as being a fair and reasonable interim payment. The interim payment was to be paid by two equal instalments on 25 March and 29 September in each year.

10. The original lease provided for an end of year reconciliation and for the appellants to meet any deficit between the expenditure actually incurred and the payments on account. In the event of a surplus clause 3(2)(e) provided that "the difference (being the unexpended surplus) shall be accumulated by the Lessors and shall be applied in or towards the Annual Cost in the next succeeding or future Accounting Period or period as aforesaid…". It seems likely that an "s" has been inadvertently omitted from the word "period" and that the intention was to refer to "the next succeeding or future Accounting Period or periods"; the sense is made clear by the words "as aforesaid" which can only be a reference to the definition of "Annual Cost" in clause 3(2)(ii) which includes not just expenditure in a particular year but also forward payments towards expenditure in future years.

11. The new lease granted to the appellants in 2014 incorporated all of the terms of the original lease. It included additional obligations, one of which was a requirement in clause 7.2.3 that within 14 days of a demand the appellants should pay "a proportion of the administration and other costs (including professional fees) of Harlow Court Ltd such proportion reflecting the tenant's shareholding in Harlow Court Ltd."

The appellants' first application and the FTT's 2018 decision

12. In 2018 the appellants applied to the FTT for a determination under section 27A, Landlord and Tenant Act 1985 of the amount of service charges payable by them in the years 2015-16 to 2017-18 and on account in the then current year 2018-19.

13. In a decision issued on 7 August 2018 the FTT recorded that it had been the practice of the original landlord, which had been continued by the respondent when it acquired the freehold, to make only two service charge demands a year each for the sum of £800. Mr Brett had explained to the FTT that this practice had been adopted in order to keep payments smooth and to provide stability. Part of the sum demanded was used to meet annually recurring expenditure and part was accumulated in a reserve fund. When the respondent took over the management of the block a substantial reserve had already built up and this was transferred to it.

14. After 2014 payments on account at the original rate of £800 per half year came to be insufficient to meet annually recurring costs with the result that there was a deficit. Rather than utilising clause 3(2)(e) to recoup the deficit from the leaseholders by a balancing demand, the respondent adhered to the original policy of demanding only two payments a year and instead drew the required funds from the reserves. By the time the matter came before the FTT in 2018 it found that no balancing demands had been made based on actual expenditure since at least 2014, nor had any proper reconciliation taken place between the

half yearly interim contributions and the total Maintenance Charges incurred. The only accounts which had been prepared were company accounts rather than service charge accounts.

15. When the FTT appreciated how the service charge had been operated it concluded that it could not determine the amount payable as a service charge because the necessary accounting reconciliations had not been undertaken. It considered that all it could do was determine whether the on account charges were reasonable. It also considered that it had no jurisdiction to make a determination under section 27A of the 1985 Act with respect to the money withdrawn from the reserves. The FTT seems to have taken a very narrow view of its powers. This Tribunal has subsequently held in a different case that there is jurisdiction under section 27A to consider whether costs met out of a reserve fund held in trust were relevant costs within the meaning of section 19, 1985 Act and therefore whether such expenditure could properly be included in a service charge: see *Eshraghi v 7-9 Avenue Road (London House) Limited* [2020] UKUT 208 (LC).

16. The FTT recorded in its 2018 decision that the appellants had agreed not to take any issue with the validity of the demands for interim payments. It went on to make a determination in relation to the sums claimed on account. It also decided that certain expenditure could not form part of the Maintenance Charge because it did not relate to the performance by the respondents of their obligations under the lease. On the true construction of the lease the FTT decided that accountancy fees, legal and professional costs, management fees and directors and officer's insurance could not be recovered as part of the Maintenance Charge. Some of those costs could be recovered under clause 7.2.3 of the new lease to the extent that they were costs of the administration of the respondent company itself but the FTT held that fees incurred in the management of the building, (as opposed to those incurred in the administration of the company) and legal fees did not fall within clause 7.2.3 or the Maintenance Charge and could not be recovered at all. Those would have to be met by the company from some other source.

The appellants' second application and the FTT's 2019 decision

17. At the hearing of the current appeal Mr Brett explained that he had withdrawn part of his objections to the service charges at the original 2018 hearing on the understanding that, from then on, the service charge regime would be operated strictly in accordance with the terms of the lease. It is not clear to me whether that is what then happened, but Mr Brett told me that it did not. It was for that reason that the appellants made a further application to the FTT in 2019, this time seeking a determination of the payability of the service charges for the six accounting years from 2013-14 to 2018-19.

18. By a decision made on 17 October 2019 the FTT struck out the second application in its entirety. In respect of the years 2015-16 to 2018-19 the FTT noted that no reconciliation for those years had yet been completed and it considered that it could do no more than determine whether the interim charges had been reasonable. As it had already determined that question in its 2018 decision it was precluded by section 27A(4) of the 1985 Act from doing so again. It noted that it had been told at the hearing that a reconciliation for the relevant years had now been completed and that it would be communicated to leaseholders very soon. In

relation to the years before 2015-16 the FTT considered that the application was an abuse of process because the issues had either been dealt with in principle in its 2018 decision or ought to have been raised in the previous application.

19. This was the second occasion on which the FTT had declined to deal with a substantial part of an application by the appellants under section 27A, 1985 Act. No real criticism can be made of its determination that the claim in relation to the earliest years should have been included with the first application in 2018 if they were to be investigated at all. Its refusal to determine what was payable in the years 2015 to 2019 is much more difficult to understand. This was the second time the fact that no reconciliation for those years had been produced by the respondent had been relied on by the FTT as an insuperable obstacle. Yet the absence of such a reconciliation was exactly the reason why the application was being made and provided no grounds at all for the FTT to refuse to make a determination. In order for the FTT to perform its statutory function it would no doubt have been necessary for it to give directions for the respondent to provide end of year accounts which would have included the appropriate reconciliations; any issues could then have been identified and addressed. Had the respondent failed to complete the accounts there could have been a debate over the consequences, but that possibility would be no reason for the FTT to decline to provide a remedy at all.

The appellants' third application

20. In June 2020 the appellants sold their flat. Before doing so they paid £1,569 (a full year's on account service charge) in response to a demand for that sum which had been issued on 18 March 2020. It had quickly been appreciated by the respondent's agents that this demand had been issued in error and that the amount claimed should have been demanded in two instalments. A revised demand was issued on 23 March 2020 in the sum of £784.50. Mr Brett told me that the revised demand had subsequently been countermanded and it was for that reason that the appellants had paid the full amount. The suggestion that the demand had been countermanded was based on a service charge statement sent on 15 May 2020 which again showed the sum of £1,569 as having fallen due on 1 April 2020. No justification was given for repeating this figure after it had already been corrected and it might be thought that the obvious explanation was that the same administrative error had occurred again. Nevertheless, the appellants paid the full amount on account before transferring their lease in June 2020.

21. On 2 September 2020 the appellants applied to the FTT for a third time. On this occasion they sought a determination under section 27A, 1985 Act of the service charges payable by them on account for the years 2018-19, 2019-20 and 2020-21.

The FTT's preliminary decision

22. The FTT conducted a preliminary hearing to determine whether any of the issues raised by the appellants had already been covered by its previous decisions or were otherwise outside its jurisdiction. On 25 November 2020 it produced a preliminary decision in which it concluded that sums totalling a little over £700 which appeared in the statements of account delivered to the appellants described as "half-yearly administration charge (company

costs)", were not service charges at all but related to the management costs of the company itself. It considered that it had no jurisdiction to determine the payability or reasonableness of those charges.

23. At the same preliminary hearing Mr Brett was recorded by the FTT as having confirmed that an end of year certificate for the Maintenance Charge incurred in 2018-19 had been served in June 2020 and that he accepted all items of expenditure in that certificate. He nevertheless contended that the on-account demands for 2019-20, and perhaps also 2020-21, should have been for lesser amounts because the appellants' account was in credit as a result of the FTT's 2018 decision.

24. Having ruled out consideration of the company costs the FTT made a number of observations which it said were not part of its decision but were provided in the hope of clarifying matters and bringing the dispute to a conclusion.

25. Mr Brett had pointed out to the FTT that in March 2019, when the 2019-20 on account service charge demand was issued, the appellants' service charge statement showed that they had a credit balance of £430.28 after taking into account a credit of £1,149 which had been applied as a result of the FTT's 2018 decision that certain expenditure was not recoverable through the service charge. The FTT observed that it was arguable that this £430.28 should have been credited against the first on-account demand for 2019-20. That was because clause 3(2)(e) of the original lease provided for any surplus to be carried forward and applied against the annual cost in the next accounting period. It also appeared from the 2018-19 end of year certificate that the appellants might have been entitled to a credit for that year of £163.69 because the interim payment had exceeded actual expenditure by that amount.

26. It was not known whether any credit would be due for 2019-20 because the end of year certificate was not yet available. The FTT nevertheless suggested that no purpose would be served by the appellants challenging the costs actually expended because any surplus was required by clause 3(2)(e) to be set against the following years' expenditure. The appellants had now sold their flat, and the FTT considered that the beneficiary of any such credit would be the current leaseholder (unless of course the terms on which the flat had been sold provided for the leaseholder to reimburse any over payment which the appellants were shown to have made). It therefore appeared to the FTT that there would be no purpose in the appellants pursuing the application at all and it invited the parties' views on what course it should take.

27. After receiving further submissions, the FTT gave case management directions on 13 January 2021. It recorded that the appellants still wished to challenge the reasonableness of the on account demands from 2018-19 onwards. They argued that expenditure in 2018-19 and 2019-20 had been covered by surplus contributions from previous years which remained unaccounted for, and that they should not have had to pay the later on-account demands. The FTT found it difficult to accept that proposition because the end of year certificates for each of the three years from 2017-18 to 2019-20 showed that actual expenditure exceeded the interim payments. It was not open to the appellants to take issue with years before March 2018 because they had not taken the opportunity to raise any objections they had to those

years in their 2018 application, and their 2019 application, which did challenge the earlier years, had been struck out.

28. As for the subsequent service charges, final year certificates were now available for the years 2018-2019 and 2019-2020. The appellants had confirmed at the 2019 preliminary hearing that they accepted the 2018-19 expenditure shown in that certificate, and the FTT ruled that the effect of section 27A(4)(a), 1985 Act was that it no longer had jurisdiction to consider any challenge to that year. 2019-20 was different, because no determination or admission had yet occurred, the appellants had been leaseholders when the expenditure was incurred and therefore they had a "valid interest" in the amount payable.

29. The FTT therefore directed that, other than the costs of the proceedings, the only issues remaining open for determination by it were:

    (1) Any challenge to the actual service charge expenditure in 2019-20 (as to which the appellants had said that they reserved their position);

    (2) Any challenge to the first on account demand of £784.50 for 2020-21 received in March 2020 and paid by the appellants before they assigned their lease; in a departure from its previous indication the FTT also stated that "as the year is not yet over any overpayment could be repayable to them."

The final hearing

30. The appellants' case before the FTT was essentially an accounting exercise which focussed on whether the respondent had correctly recorded its expenditure and properly distinguished between the different capacities in which it was entitled to collect funds from the leaseholders and its own shareholders. That was not simply an exercise in pedantry because, as Mr Brett pointed out, the appellants were contractually obliged to pay sums properly demanded as service charges, but they were under no obligation to make good a deficit in the respondent's own management accounts except to the extent that they were covered by clause 7.2.3 of the new lease. The appellants are no longer shareholders or leaseholders and by June 2021 it had become too late for the respondent to make valid demands that they contribute to the running costs of the company. By the end of the proceedings it appeared that the only substantive issue considered by the FTT concerned the reasonableness of the March 2020 on-account demand having regard to the correct allocation of sums incorrectly collected as service charges.

31. The sum demanded on 18 March was 5.56% of the budgeted expenditure for the 2020-21 year and the revised demand on 23 March 2020 was for half that amount. The FTT recorded that the appellants did not argue that any of the budgeted costs were invalid or were for a greater sum than was reasonable. They did challenge the on-account demand on four grounds unrelated to the budget. Two of these were technical points which the FTT dismissed in short order. The remaining points raised essentially the same issue about the reasonableness of the demand. The appellant's first argument was that the estimated amount was not "a fair and reasonable estimate" as required by clause 3(2)(b) of the lease, while their second point was that the demand was for a greater amount than was reasonable as a

payment in advance and should therefore be limited in accordance with section 19(2) of the 1985 Act.

32. The appellants' case on reasonableness began by pointing out that the 2018-19 accounts showed a service charge income of £20,400 whereas (as the respondent agreed) the sum actually collected had been £24,600. The appellants said that £4,200 had wrongly been appropriated by the respondent to cover company costs and other expenses which the FTT had ruled fell outside the service charge. Actual expenditure in that year had been £21,652.

33. Secondly, the appellants asserted that, contrary to the impression which had previously been created, for every year from 2015-16 onwards there had been a surplus on the service charge account which the demands for interim payments had failed to take into account.

34. Thirdly, the sums charged to the service charge account in 2017-18 included £4,775 for management charges and £6,477 for legal fees which the FTT's decision of August 2018 had determined were not recoverable as service charge items.

35. Taking account of each of these points, and including sums held in reserve, Mr Brett's own detailed calculations showed that there was an accumulated surplus of £34,351. The appellants' case was that all of these sums should have been taken into account when interim payments were assessed for 2019-20 and beyond, and the existence of the surplus was relevant to a determination of the contractual and statutory questions of whether the interim charges were reasonable in amount. Mr Brett submitted to the FTT that by 2020-21 there should have been no on account demands at all, as the surplus funds available were more than enough to cover the anticipated budget for that year.

36. The respondent acknowledged to the FTT that errors had been made in treating company costs as if they were service charge items in 2018-19. The sum incorrectly attributed in the service charge accounts had been £4,200, as the appellants had suggested. The respondent had decided against restating the 2018-19 accounts; it had considered that doing so would not be proportionate, or of any real benefit to the leaseholders and shareholders (who were the same people) because any adjustment would simply have involved moving funds from the company accounts to the service charge accounts thereby creating a loss in the former and an equivalent surplus in the latter. Moreover, all of the leaseholders other than the appellants had agreed to the treatment of the discrepancy in this way after it had been explained to them by the respondent in a letter of 7 December 2020. The respondent explained that it had undertaken a comprehensive reconciliation exercise, and to the extent that there was a credit due to leaseholders on their service charge accounts it was applied towards a deficit on the company's own accounts to cover costs that it was no longer entitled to recover through the service charge.

The FTT's decision

37. The FTT recorded the appellants' primary contention as follows:

> "Due to the non-recoverability of management and legal fees through the service charge, the on-account demands made since August 2018 have been too high.

> The retrospective disallowance of these fees means that there are surpluses arising in previous service charge years, which in turn mean that later demands should have been for less or for nothing at all."

38. The FTT noted that the appellants did not challenge the reasonableness or payability of any of the actual expenditure shown in the service charge certificates for 2018-19 and 2019-20. The FTT refused to determine whether the on-account sums demanded in those years were reasonable and payable on the basis that it would be a pointless exercise:

> "Even if the sums demanded on account were too high, once the service charge certificate has been produced clause 3(2)(e) of the lease provides that surplus funds collected but unspent would be retained by the lessor and applied towards future costs. There is no provision for repayment to the lessee, and as the appellant has disposed of their interest, the surplus will accrue for the benefit of the current lessee."

39. At paragraph 21 of its decision the FTT said that the only substantive issue was the first 2020-21 on-account demand which the appellants had paid before disposing of their lease. It referred to the confusion in March 2020 over the amount payable on account but it does not appear to have appreciated that the appellants had paid the greater sum, which was twice as much as was properly due; it referred instead to them having paid "the first on-account demand". The amount actually paid does not affect the first question raised by the appeal, which concerns the amount which was it reasonable for the respondent to claim in advance in March 2020, but it may be relevant to the amount of any overpayment which the appellants may be entitled to recover or which should be credited to the account of their purchaser.

40. In paragraph 33 the FTT dismissed the appellant's contractual challenge to the on-account demand. The sum demanded had been specified by the respondent's surveyor to be fair and reasonable and the FTT considered that it was therefore payable under the lease unless it exceeded the statutory cap because it was for a greater amount than was reasonable as a payment in advance.

41. In ruling on the effect of section 19(2), 1985 Act the FTT essentially accepted the respondent's explanation that, taking into account both the service charge and the company's running costs, no surplus existed as a result of an over collection of funds because all of the money collected had been applied either towards the services covered by the Maintenance Charge or towards the company's legitimate running expenses. It acknowledged that the sums disallowed for legal and management fees by the FTT's 2018 decision exceeded the £784.50 demanded on account in March 2020. It was also true that when the on-account demand was made, strictly, there were credits on the service charge account which exceeded the amount being demanded for the full year. The FTT asked itself whether those aspects of the respondent's performance in previous years meant that the amount demanded on account for 2020-21 was greater than was reasonable. It answered that question in paragraphs 52-54 of its decision as follows:

> "52. The respondent was faced with the situation where, as a result of the first application made to the Tribunal, the costs recovery regime it had operated since enfranchisement (initially sanctioned if not authorised by Mr Brett as a director) was found to be incorrect. Service charge funds had been used to pay costs incurred by the respondent but not of a type recoverable through the service charge. However, the resulting credits due on the service charge account were not represented by actual funds, because the monies had already been spent. The respondent still required ongoing service charge income to pay ongoing costs.
>
> 53. As the respondent is lessee-owned, its only other source of funds is the leaseholders *quae* shareholders. The respondent has had, retrospectively, to make adjustments so the costs now disallowed as service charges are reallocated as company costs, paid by the shareholders.
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> 54. Service charge funds are held in trust for the persons who are the contributing tenants for the time being (section 42(3), Landlord and Tenant Act 1987). Thus funds or credits can only be moved out of the service charge account to pay costs that are not service charges if the beneficiaries i.e. the contributing tenants, agree. It appears that most if not all the leaseholders, apart from the applicants have so agreed. This would seem an entirely pragmatic and sensible approach. There is little point in relieving lessees of their obligation to make regular modest payments towards ongoing service charges until their notional credits are used up, if at the same time those same people receive a company bill for a very large sum which must be paid immediately. Moreover, the respondent would need to reimburse the funds received from the shareholders back to the service charge account. The company cannot retain funding for company costs that have already been paid from service charge monies; the service charge account must be reimbursed. From this perspective, the tribunal does not consider the demand made in March 2020 to be unreasonable."

42. The FTT next asked itself whether the procedure which had been adopted by the respondent contravened clause 3(2)(e) of the lease. It interpreted this clause as requiring that the amount unexpended at a year-end must be accumulated and applied towards future costs. But, the FTT said: "the monies paid on account prior to 2019/20 had all been expended, albeit not on service charge expenditure." As of March 2020, the only surplus was a sum of £2,590 from 2019-20 year which the FTT considered should have been applied towards the 2021 budget which would have reduced the demand sent to the appellants by £71.95. On that basis the FTT considered that the reasonable amount payable by the appellants in respect of the March 2020 on account demand should have been £712.55 instead of £784.50.

The grounds of appeal

43. The appellants' application for permission to appeal ran to 74 paragraphs but permission was refused on all grounds by the FTT. Permission was granted by this Tribunal on the following two grounds:

(1) Whether the interim service charges demanded for the second half of 2018-19, for 2019-20 and for the first half of 2020-21 were unreasonable because the respondent held funds to the appellants' credit as a result of the FTT's decision of 7 August 2018, which made it unreasonable for it to demand further sums when the appellants had not consented to the re-designation of the credit as a payment to meet company expenditure pursuant to clause 7.2.3 of the new lease.

(2) Whether the FTT was correct to find that, in so far as the disputed demands were unreasonable, the resulting credit to the applicants' service charge account would accrue to their assignee under clause 3(2)(e) of the lease, rather than being repayable to the appellants (that being the basis on which the FTT had refused to consider the appellants' claim to be entitled to credits in 2018-19 and 2019-20).

Issue 1: Were the on-account demands rendered unreasonable by the historic credits?

44. This appeal is against the FTT's decision of 1 June 2021 determining the appellants' third application, and it is therefore necessary to keep in mind the issues which the FTT was entitled to consider at that hearing. There was no appeal against the 2018 or 2019 decisions, nor did the appellants seek permission to appeal the preliminary decision of 25 November 2020.

45. The four interim service charges which the Tribunal identified when it gave permission to appeal amounted in total to the sum of £2,805. Of that total the amount demanded for the half-year beginning in March 2020 was £784.50. The only amount in issue before the FTT at the final hearing in May 2021 was the sum of £784.50, because in its directions of 13 January 2021 the FTT had identified the first 2020-21 on account demand as the only one in respect of which the appellants were entitled to raise a challenge. The end of year certificates were available for 2018-19 and 2019-20 and at the preliminary hearing Mr Brett had confirmed that he accepted the expenditure in the first of those years; the appellants then conceded in their statements of case that they did not challenge the reasonableness of payability of any of the actual expenditure in 2019-20.

46. Since the on-account service charges of September 2018 and March and September 2019 were not the subject of the FTT's decision under appeal, it might be argued that the Tribunal ought not to have granted permission to appeal extending to those charges which had been eliminated from consideration by the FTT's decision of 13 January 2021. But the application for permission to appeal clearly included the appellants' case concerning all of the payments. It is open to the Tribunal, in an appropriate case, to give permission to appeal a decision out of time and that, in effect, is what it did when granting permission in this case in relation to the three payments which the FTT had not considered in its final decision. The scope of any appeal cannot be wider than the scope of the original proceedings, but the appellants' third application sought a determination of the on-account service charges payable by them for the years 2018-19, 2019-20 and 2020-21. The decision of 13 January 2021 was not only a case management decision, but was in effect a decision on preliminary issues, which ruled out of consideration the challenges which the appellants wanted to bring against all of the on-account payments since the FTT's 2018 decision. The appellants had not sought permission to appeal that decision when it was made, but they have acted throughout the

proceedings without the benefit of legal advice and it was consistent with the Tribunal's overriding objective of dealing with appeals fairly and justly that permission to appeal should be granted in respect of all four disputed charges.

47. Despite the narrow focus of the FTT's decision, and the slightly more generous scope of the issues identified in the Tribunal's grant of permission to appeal, Mr Brett wished to address the Tribunal on a far wider lists of issues. It was not always easy to follow his submissions but the fundamental principle on which he proceeded was that the terms of the lease should have been strictly adhered to and the liabilities of the company's shareholders should have been scrupulously distinguished and accounted for separately from the service charges payable by the same people in their capacity as leaseholders. It is difficult to disagree with any of that as a matter of principle.

48. Unfortunately, this appeal is another example of a lessee owned block where, over a lengthy period, contractual service charge machinery has not been faithfully followed. For so long as all parties get along well these modest irregularities of approach usually pass without objection, but they can lay the foundations for substantial accounting problems in the event the parties fall out, as they have in this case.

49. The first issue is not about how well the respondent implemented the service charge machinery but rather is the much narrower question of whether the sums demanded on account, including the £784.50 demanded in March 2020, were reasonable amounts for the respondent to demand in respect of its anticipated annual expenditure, which in 2020-21 was £28,235. In each year the sum demanded was the appellants' pro rota share of the budget and the question is whether in all the circumstances that amount was a reasonable one to expect the appellants to pay in advance. The only circumstances making this case in any way unusual arise out of two previous irregularities, one concerning the collection of funds which were not recoverable at all under the lease (including professional fees), and the second in failing to distinguish between the costs of services recoverable under clause 3(2) of the original lease and the costs of company administration recoverable under clause 7.2.3 of the new lease.

50. Whether it is reasonable to demand a sum in advance as a contribution towards costs to be incurred in providing services and carrying out works to a residential block is not an accounting question. That is demonstrated by the decision of the Court of Appeal in *Avon Ground Rent Ltd v Cowley* [2019] EWCA Civ 1827. In that case this Tribunal had decided that the amount which it was reasonable to expect leaseholders to pay for the forthcoming year should be determined taking into account anticipated receipts from an insurance claim which would cover the cost of remedial work which the appellant would otherwise have been entitled to recoup through the service charge. The Tribunal held that an on-account demand equal to the full cost of the remedial works was not a reasonable amount for the leaseholders to pay in advance in circumstances where receipt of a near equivalent amount was anticipated from the insurer.

51. On the landlord's appeal the decision of the Court of Appeal was given by Nicola Davies LJ. At [31] she explained why the Tribunal's approach had been correct:

> "Whether an amount is reasonable as a payment in advance is not generally to be determined by the application of rigid rules but must be assessed in the light of the specific facts of the specific case. A number of considerations ought or may properly have to be taken into account in determining the question of reasonableness under section 19(2) which would include the time at which the landlord would, or would be likely to, become liable for the costs, and how certain the amount of those costs is".

At [33] she continued:

> "As to what is "reasonable" it is for the relevant tribunal to determine, as was done by the FTT in these proceedings. It is an exercise which the Tribunal is well-equipped to perform, assessing the relevant facts of each individual case and arriving at a determination based upon the evidence."

52. A number of strands of thinking can be identified in the FTT's decision as having caused it to conclude that the sum of £712.55 (instead of the £784.50 demanded in March 2020) was a reasonable contribution for the respondent to collect in advance. First, the funds which had been collected by the respondent since the FTT's first decision had been expended by it on works and services which were not challenged by the appellants on grounds that the cost incurred or the quality of the service were unreasonable, but purely on grounds that in part they had been collected and accounted for under an inappropriate label. Secondly, in principle, it was reasonable for the payment on-account to be based on the whole of the following year's budget. Thirdly, while the approach which had been taken by the respondent in preceding years had not been strictly in accordance with the lease, the difference between the amount collected and the actual expenditure in the most recent complete year was modest and the total sum available to be set off against the anticipated expenditure for 2020-21 was only about £2,590. Fourthly, the FTT was attracted by the "pragmatic and sensible approach" taken by the respondent, with the agreement of almost all leaseholders other than the appellants, which sought to avoid any further complicated accounting exercise involving the transfer of funds from the company to the service charge account and back again.

53. In a case like this it is not for this Tribunal to substitute its own view of what is the reasonable amount to be collected as a service charge payable in advance. That was a decision for the FTT. In the Tribunal's decision in *Avon Ground Rents v Cowley* [2018] UKUT 92(LC), at [57], it explained:

> "The reasonable amount of the advanced payment was a matter of judgment on which different views are possible, but this Tribunal will not interfere with a judgment of the FTT of that sort unless it has taken into account something irrelevant or failed to take into account something relevant or has otherwise reached a conclusion which was not open to it."

54. In *Sheffield City Council v Oliver* [2017] EWCA Civ 225, at [58], Briggs LJ said that while he might have reached a different conclusion if making a similar decision for himself, the

Court of Appeal should not disturb a similar assessment by this Tribunal which was "within the range of fair outcomes available to the decision-maker".

55. In *Avon Ground Rents v Cowley* the Court of Appeal appears to have taken the same approach; at [36] Nichola Davies LJ said that in "determining what was a reasonable amount to be paid by the respondents the FTT was entitled to take into account all relevant circumstances as they existed at the date of the hearing, given such weight to the varying factors as it considered just and reasonable." At [37] she concluded that "the FTT properly exercised its discretion in making the final determination which it did."

56. Applying the same approach, I am satisfied that the FTT was entitled to reach the conclusion it did. It could have decided that a line ought to be drawn under the previous lax approach to accounting and that all sums collected in the past under an inappropriate label should be reattributed and credits given where required in the service charge account, with demands being made under clause 7.2.3 for equivalent sums to fund the company costs. But in my judgment, it was not obliged to take that approach. It was entitled to reason that the leaseholders were responsible for the expenditure which had actually been incurred, whether through the service charge or clause 7.2.3 or, perhaps as a last resort, voluntarily if they wished the respondent to remain solvent. It was entitled to take into account that there were no significant funds in hand which could have been used to reduce the payments on account, because the money collected had been used for its intended purposes. Most importantly, funds were required to meet anticipated routine expenditure, and nothing was to be gained by a more complicated accounting exercise. The leaseholders would not pay more in the current year than the respondent needed to provide the covenanted services and would be spared the additional expense of flawless accounting. For these reasons I am satisfied that the FTT in this case was entitled to find that an advanced payment of £712.55 was a reasonable one to expect the appellants to pay.

57. Although the FTT did not address the three previous payments on account in its decision, it is obvious that a similar approach would have been taken if it had not already excluded those years from consideration. It is the approach which I would take and I therefore determine that the half yearly instalments of £566.67 demanded on 29 August 2019 and the two instalments of £729.44 demanded on 22 May and 4 September 2019 were also reasonable.

58. I therefore dismiss the appeal on the first ground.

59. Before leaving this ground of appeal I will deal with some of the points raised by Mr Brett in argument which I have not yet referred to.

60. The FTT considered that the respondent was not required by clause 3(2)(e) of the original lease to give credit for sums which it had collected if it had actually spent those sums. In paragraph 58 of the decision it said that the requirement to credit money against future expenditure "applies to monies demanded which have not been spent". I do not think this part of the FTT's reasoning was correct. Clause 3(2)(e) required a comparison between the Maintenance Charge and the Interim Sum specified by the respondent's surveyor as a fair and reasonable Interim Sum. If the Interim Sum proved to be greater than the Maintenance Charge, the respondent was required to deal with the balance in the manner directed by the

clause. It was not entitled to say that it had spent more than the Maintenance Charge so there was no unexpended surplus. That is what had happened in the years before 2018, when company costs which were not properly within the scope of the Maintenance Charge had been paid out and accounted for as if they were.

61. But clause 3(2)(e) did not require that the leaseholders be given credit straight away and for the full amount of any surplus of Maintenance Charge over Interim Sum. It permitted the unexpended surplus to be applied towards the Annual Cost in "the next succeeding or future Accounting Period or period as aforesaid". There was therefore no absolute obligation on the respondent to use a surplus from one year to reduce the payments for the immediately following year.

62. Nor were the appellants entitled to expect that the whole of the reserve fund would be used to meet the anticipated recurring expenditure of the forthcoming year. The lease specifically entitled the respondent to collect funds as a sinking fund to meet larger items of expenditure in subsequent accounting periods. The suggestion that the leaseholders should have been entitled to a service charge holiday for a year or more depended on the liquidation of the reserve funds, which was not something the appellants were entitled to insist on.

63. Nor was it the case that the sums identified in the FTT's 2018 decision as beyond the respondent's charging powers had been left out of account, as Mr Brett argued on the appeal. The management and legal fees which the FTT had disallowed in 2018 came to £18,182, of which the appellants' share was £1,111. The appellants' statement of account (the only example I saw was dated 18 October 2019) shows that on 26 November 2018, three months or so after the publication of the FTT's first decision, a "management fee refund" of £1,149 was applied to the appellants' account, reducing the balance to a credit sum of £430.28. The sum which the FTT had found to be overpaid had therefore been repaid to the appellants by means of this credit before the payments on account for 2019-20 were demanded and it was not available to be taken into account in determining the reasonableness of those payments or payments in the following year.

64. Mr Brett suggested that the sum actually expended towards legal and professional and management fees in the year to March 2018 had been greater than the sum which had been budgeted for and that a greater sum should therefore have been credited. But by its decision of 13 January 2021 the FTT had refused to permit the appellants to widen the scope of their application to incorporate an investigation of the respondent's actual expenditure in the years 2015-16 to 2017-18. Their attempt to do so in 2019 had also been struck out. In order to determine whether there was any surplus for 2017-18 available to be carried forward and capable of being set off against subsequent payments on account it would have been necessary to undertake exactly the investigation which the FTT had refused to permit because it could have formed part of the appellants' case advanced in 2018. There was no appeal against that decision and it would not be appropriate to permit one at this late stage.

Issue 2: How should any surplus have been treated?

65. In view of my conclusion on the first ground of appeal, the second ground can be dealt with shortly. The FTT had refused to consider the appellants' case that the on-account sums

demanded in 2018 and 2019 should have been reduced by the suggested surpluses in previous years because it considered that would be a pointless exercise, since the appellants would not be entitled to receive a repayment of any excess contribution and the only beneficiary of any resulting credit would be the appellants' purchaser, who was not party to the application. The FTT made an exception for the payment on account demanded in March 2020 because the final accounting for that year had not yet occurred so the contractual direction about how any surplus was to be applied had not yet taken effect.

66. Mr Brett submitted that, contrary to the view taken by the FTT, the second limb of section 19(2), 1985 Act required that any amount that was found to be more than was reasonable as a payment in advance should be repaid to the appellants and ought not to be carried forward to the following accounting year to be set against future anticipated expenditure. He sought an order for repayment, with interest, of sums found to have been overpaid.

67. Section 19(2) is set out in paragraph 6 above. It will be remembered that it provides that "after the relevant costs have been incurred any necessary adjustments should be made by repayment, reduction or subsequent charges or otherwise".

68. In *Knapper v Francis* [2017] UKUT 3 (LC) the Tribunal determined at [43] that section 19(2) did not confer any jurisdiction on the FTT beyond that which was already conferred by section 27A, 1985 Act. The FTT's jurisdiction under section 27A is a declaratory one which does not allow the Tribunal to order the repayment of sums paid in excess of the relevant statutory service charge limit. For that reason, even if the appeal had succeeded on the first ground, I would have dismissed the second ground and held that any remedy to recover sums found to have been overpaid by the appellants would have had to be pursued in the County Court and could not have been the subject of an order for repayment made by the FTT.

Martin Rodger QC,
Deputy Chamber President

23 February 2022

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.