SERVICE CHARGES AFTER THE RUDDY DECISION – STATUTORY REGULATION OF COMMERCIAL LEASES?

INTRODUCTION - THE PROBLEM

1. You act for a freeholder of premises comprising 24 flats on the upper floors and commercial premises at ground level. The upper floors are let to a company on a long head-lease. The flats are sublet by the company to residential occupiers on long leases. The company is controlled by a majority of the subtenants. The commercial premises are separately let to a third party.

2. Pursuant to its obligations in the headlease the freeholder has incurred a maintenance charge by carrying out repairs to the building, and pursuant to the head-lease has passed the maintenance charge on to the head lessee. The head-lessee in turn has charged each of the sub-tenants one twenty-fourth of the maintenance charge in accordance with the underleases.

3. One of the residential sub-tenants is unhappy with the cost and standard of the works to which the maintenance charge relates. Coincidentally he is not a member of the head-lessee company. He has commenced proceedings in the LVT under s.27A of the LTA 1985 challenging the reasonableness of the maintenance charge.

4. What advice do you give the freeholder?

THE LEGISLATION

5. The relevant legislation is the Landlord and Tenant Act 1985 (as amended).

s 18 Meaning of "service charge" and "relevant costs".

(1) In the following provisions of this Act "service charge" means an amount payable by *a tenant of a dwelling* as part of or in addition to the rent--

(a) which is payable, directly or indirectly, for services, repairs, maintenance, improvements or insurance or the landlord's costs of management, and

(b) the whole or part of which varies or may vary according to the relevant costs.

(2) The relevant costs are the costs or estimated costs incurred or to be incurred by or on behalf of the landlord, or a superior landlord, in connection with the matters for which the service charge is payable.

(3) …

s **27A** Liability to pay service charges: jurisdiction

(1) An application may be made to a leasehold valuation tribunal for a determination whether a service charge is payable and, if it is, as to--

(a) the person by whom it is payable,

(b) the person to whom it is payable,

(c) the amount which is payable,

(d) the date at or by which it is payable, and

(e) the manner in which it is payable.

(2) – (7)

s **38** Minor definitions

In this Act—

…

"dwelling" means a building or part of a building occupied or intended to be occupied as a separate dwelling, together with any yard, garden, outhouses and appurtenances belonging to it or usually enjoyed with it;

THE ISSUES

6. Two interesting issues of principle are raised by the subtenant's application

Issue 1

Is the maintenance charge a service charge within the meaning of s.18? Note that the definition of service charge relates to "*an amount payable by a tenant of a dwelling*"

Dwelling is in the singular - does this include a mesne landlord who is a tenant of not one but several dwellings?

Issue 2

Does the subtenant have a standing under s.27A to challenge an amount payable under a headlease to which he is not party?

7. These were the two issues raised by the decision of the Court of Appeal in *Oakfern Properties Limited v Ruddy* [2006] EWCA 1389, [2007] 1 All ER 337.

EARLIER CONSIDERATION OF THE ISSUES

Horford Investments Ltd v Lambert [1976] 1 Ch 39 (CA)

8. The tenant of two houses, each of which divided into flats, was not a protected tenant under the Rent Act 1968 because each house was not "let as *a* separate *dwelling*." The Interpretation Act 1889 did not apply with result that the use of the singular *dwelling* did not include the plural *dwellings*.

Heron Maple House Ltd v Central Estates Ltd [2002] 1 EGLR 35 (Cty Ct)

9. Section 20 LTA 1985 consultation requirements were held to apply to a head-lease where the landlord carried out works of repair in excess of the statutory limit and had failed to consult.

ANALYSIS BY THE COURT OF APPEAL

Issue 1

10. S.38 LTA 1985 definition of dwelling has two limbs. The second reads "*"dwelling" means ...part of a building occupied or intended to be occupied as a separate dwelling*".

11. Jonathan Parker LJ stated:

> "I can find no satisfactory reason for construing definition of "*dwelling*" in section 38 so as to exclude a tenant from the definition merely because whilst he is the tenant of a dwelling which extends only to part of a building, he is also the tenant of other parts of the building, be such other parts dwellings or common parts or some other type of property altogether (e.g. commercial property)." [2006] EWCA Civ 1389, 74

12. Even if a head-tenant owns the entire building, it is nonetheless a tenant of part of a building occupied or intended to be occupied as a separate dwelling : [2006] EWCA 1389, 73

13. The legislative context does not lead to a contrary conclusion. In particular, there is no analogy with the Rent Acts, to which different policy considerations apply: [2006] EWCA 1389, 78

<u>Issue 2</u>

14. There is no justification for implying any limit into the general words of s.27A. In most cases, the applicant for a determination will be the paying party.

15. In the event of a vexatious or abusive application by a busybody, the LVT has ample powers to strike out. [2006] EWCA 1389, 82-84

IMPLICATIONS FOR LANDLORDS

16. The decision of the Court of Appeal has potentially wide-reaching consequences for landlords of mixed-use buildings and intermediate landlords.

    - A commercial head-lessee can challenge service charges imposed by the freeholder using statutory provisions intended for residential tenants if the head-lease includes premises occupied or intended to be occupied as a separate dwelling
    - It takes commercial service charges out of the purely contractual sphere

- The 1985 Act will apply even to a janitor's flat forming part of shopping centre. Even if s/he is only a service occupier.

- Consultation requirements will apply between the freeholder and the head-lessee to any major works exceeding the current statutory limit of £250[1] even if the cost per sub-tenant is below the appropriate amount.

17. How did the Court of Appeal deal with these issues?

- Alternative constructions of s.18 produce various anomalies – this is the least awkward solution [2006] EWCA 1389, 80.

- S.18(2) enables subtenant to challenge costs imposed by freeholder, but would still be payable by the head lessee to the freeholder [2006] EWCA 1389, 56

- This would lead to head-lessee making a loss.

- Why should a janitor who is a tenant not be protected from an unreasonable service charge?

FURTHER IMPLICATIONS

18. Various significant knock-on effects were *not* canvassed before the court. Some of these are as follow.

- Restrictions on freeholder's right to forfeit head-lease for unpaid service charges – s.81 Housing Act 1996?

> **s 81 Restriction on termination of tenancy for failure to pay service charge.**
>
> (1) A landlord may not, in relation to premises let as a dwelling, exercise a right of re-entry or forfeiture for failure by a tenant to pay a service charge or administration charge unless--
>
> (a) it is finally determined by (or on appeal from) a leasehold valuation tribunal or by a court, or by an arbitral tribunal in

[1] The Service Charges(Consultation Requirements) (England) Regulations 2003 SI 2003 No 1987

proceedings pursuant to a post-dispute arbitration agreement, that the amount of the service charge or administration charge is payable by him, or

(b) the tenant has admitted that it is so payable.

(2)-(4) …

(4A) References in this section to the exercise of a right of re-entry or forfeiture include the service of a notice under section 146(1) of the Law of Property Act 1925 (restriction on re-entry or forfeiture).

(5) In this section

(a)-(b) …

(c) "dwelling" has the same meaning as in the Landlord and Tenant Act 1985 (c. 70), and

(d) "service charge" means a service charge within the meaning of section 18(1) of the Landlord and Tenant Act 1985, other than one excluded from that section by section 27 of that Act (rent of dwelling registered and not entered as variable).

(5A)-(6)…

- Determination of breach prior to forfeiture – Commonhold and Leasehold Reform Act 2002 s.168? Section 169(5) – “dwelling” has the same meaning as in the 1985 Act

- Section 166 – requirement to notify long leaseholders that rent is due. Section 166(9) gives dwelling the same meaning as the 1985 Act.

- Section 167 – restriction on forfeiture to pay small amount for short period – rent or administration charges. Section 167(5) gives dwelling the same meaning as the 1985 Act.

- Schedule 11 – administration charges.

Para 1

(1) In this Part of this Schedule "administration charge" means an amount payable by a tenant of a dwelling as part of or in addition to the rent which is payable, directly or indirectly—

(a) for or in connection with the grant of approvals under his lease, or applications for such approvals,

(b) for or in connection with the provision of information or documents by or on behalf of the landlord or a person who is party to his lease otherwise than as landlord or tenant,

(c) in respect of a failure by the tenant to make a payment by the due date to the landlord or a person who is party to his lease otherwise than as landlord or tenant, or

(d) in connection with a breach (or alleged breach) of a covenant or condition in his lease.

- Others?

- Did Parliament really intend to regulate commercial leases in this way?

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