LRX/175/2007

LANDS TRIBUNAL ACT 1949

LANDLORD AND TENANT – service charge – lease granted pursuant to the right to buy provisions of the Housing Act 1985 – construction of lease – construction in the context of the admissible background including the terms of the landlord's s.125 notice – whether landlord entitled to charge instalments towards future repairs and to hold such sums in a reserve fund

IN THE MATTER OF AN APPEAL AGAINST A DECISION OF THE LEASEHOLD VALUATION TRIBUNAL FOR THE MIDLAND RENT ASSESSMENT PANEL

BETWEEN **LEICESTER CITY COUNCIL** **Appellant**

and

THEO MASTER **Respondent**

Re: 87 Tournament Road
Leicester LE3 8LS

Before: His Honour Judge Huskinson

Sitting at Procession House, 110 New Bridge Street, London EC4V 6JL
on 29 October 2008

Andrew Arden QC and Stephen Beresford, instructed by Peter Nicholls, LLM, Service Director of Legal Services for Leicester City Council for the Appellant
The Respondent did not appear and was not represented

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The following cases are referred to in this decision:

Riverside Housing Association Ltd v White [2007] UKHL 20; [2007] 4 All ER 97
Investors Compensation Scheme Ltd v West Bromwich Building Society [1988] 1 WLR896 HL
Bristol City Council v Lovell [1998] 1 WLR 446 HL
LB Brent v Hamilton LRX/51/2005
Norwich City Council v Marshall LRX/114/2007
Gilje v Charlgrove Securities Ltd [2001] EWCA Civ 1777

The following cases were also referred to in argument:

Edley v Leicester City Council (LVT) (2005) ("Glenhills Boulevard")
Mihovilovic v Leicester City Council (LVT) (2007) ("Kashmir Road")
St Mary's Mansions Ltd v Limegate Investments Ltd [2002] EWCA Civ 149
Hyam & Anderson v Wilfred East London Housing Co-op (LVT) (2005) ("Corbin House")
Schilling v Canary Riverside Management Ltd (Lands Tribunal – HHJ Mole QC) LRX/41/2007

DECISION

Introduction

1. The Appellant appeals from the decision of the Leasehold Valuation Tribunal for the Midland Rent Assessment Panel (the LVT) dated 15 October 2007 whereby the LVT, upon an application made to it by the Respondent under section 27A of the Landlord and Tenant Act 1985 as amended, decided that the Appellant was not entitled to claim from the Respondent, through the service charge provisions in his lease, instalments towards future repairs which would in due course need to be done to his premises (or the building comprising his premises) and to hold such sums in a reserve fund. The LVT also made certain subsidiary decisions which the Appellant also challenges.

2. The Respondent holds 87 Tournament Road from the Appellant under a long lease at a low rent granted to him pursuant to the right to buy provisions of the Housing Act 1985, the lease being dated 18 April 2005. The principal point raised in this appeal concerns a point of construction in the Respondent's lease, which is in the standard form used by the Appellant when long leases are granted pursuant to the right to buy legislation. The question is whether the terms of this lease are sufficiently wide to enable the Appellant to operate through the service charge provisions a reserve fund for future expenditure on repairs. The Appellant also argues that, if it is successful on this main point, then the Lands Tribunal should reverse certain findings which the LVT made on an alternative basis (ie on the basis of supposing, contrary to the LVT's principal finding, the Appellant was entitled to operate a reserve fund). These findings which are challenged are to the effect, even if a reserve fund was permitted, certain of the items of charge which the Appellant had included within the service demand should be disallowed. The appeal also raises certain subsidiary matters concerning the recoverability of the costs to the Appellant of carrying out certain works to the Respondent's premises in February 2006 ("the February works") and raises the question of whether, if payment is not recoverable in instalments under the reserve fund scheme in respect of such works, any valid demand for payment for service charge in respect of the February works was made within the time limit set forth in section 20B of the 1985 Act and whether in consequence anything is recoverable by the Appellant in respect of such works. The LVT held that there had been no such valid demand and nothing was recoverable in respect of the February works.

3. The LVT granted the Appellant permission to appeal to the Lands Tribunal in respect of its ruling on the main point, namely that the Appellant was not entitled to charge the Respondent, through the service charge provisions, instalments towards future repair costs and to hold these as a reserve fund in anticipation of the eventual repair work being carried out. This Tribunal granted the Appellant permission to pursue certain other points raised in the grounds of appeal, namely the challenge to the LVT's decision that no valid demand had been served for payment of service charge in respect of the February works and also the LVT's consequential decisions on costs.

4. The Respondent was notified in the normal manner by the Tribunal of the appeal. The Respondent did not give notice of an intention to respond in accordance with Rule 7 of the Lands Tribunal Rules 1996 as amended. The Respondent did not appear and was not

represented at the hearing and has submitted no statement of case in opposition to the Appellant's appeal. This does not of course mean that the Appellant's appeal should in some way be therefore allowed for want of any response by the Respondent. The appeal can only be allowed if the Tribunal is persuaded that the LVT's decision was wrong.

Facts

5. The Respondent was a secure tenant of 87 Tournament Road, Leicester ("the Flat"). The Flat constitutes the first floor flat in a two storey building ("the Building"). The other dwelling within the Building is the ground floor flat and I was told that this was held by a secure tenant.

6. The Respondent was entitled to exercise his right to buy under the Housing Act 1985 and by a notice dated 3 August 2004 the Respondent claimed his right to buy which was admitted by the Appellant. In consequence the Appellant, through Mr Robert Gotts of the Technical Services Section of the Appellant's Housing Department, carried out a dilapidation survey of the Building and he produced a document entitled Survey for Service Costs – Flats and Maisonettes dated 21 October 2004, which was before the LVT and which was used by the Appellant for the purpose of preparing the contents of the Appellant's section 125 notice mentioned below.

7. By a section 125 notice dated 16 November 2004 the Appellant notified the Respondent of the various matters it was statutorily required to notify him about, including the price and its calculation and the existence of certain structural defects and also as regards the level of service charge which would be levied on the Respondent during the initial five year period. The terms of the section 125 notice in this regard were as follows:

> "7. A service charge estimated (at current prices) at average of 207 per year will be made. This is calculated as follows
>
> | Head of Charge | Amount |
> |---|---|
> | Administration | £124.22 |
> | Building Insurance | £ 37.80 |
> | Waylighting | £ 44.76 |
> | Total | £207.00 |
>
> The above figures will be subject to yearly review and revision.
>
> N.B. If a warning alarm system is installed or a Pendant alarm is provided the charge for such service is not included above. Such charges will be invoiced separately to lessees by the Director of Housing.
>
> 8. A service charge in respect of the following works of repair (including the making good of any structural defects) will be made. Such charge has been estimated as follows:-

a) Landlords estimate provision in respect of anticipated repairs within the initial five year period

Details of Works	Estimated amounts (at current prices) of likely cost	I or B	Estimate of your likely annual contribution
Doors - Entrance (unglzd) + glzd comb frame	£108.00	I	£108.00
Doors - internal (unglzd) – a	£26.85	I	£26.85
Doors - internal (unglzd) – b	£32.63	B	£16.32
Electrical/waylights	£36.76	B	£18.38
Fascias etc - barge boards	£22.48	B	£11.24
Fascias etc - fascias & soffits	£49.39	B	£24.70
Fencing – Gates	£13.29	B	£6.65
Painting/external (block)	£21.29	B	£10.65
Painting Internal – (Individual)	£4.97	I	£4.97
Painting Internal (Block)	£54.54	B	£27.28
Painting/external (individual)	£21.58	I	£21.58
Soil/service stacks/shared	£27.80	B	£13.90
Window steel (b)	£50.70	B	£25.35
Windows steel (a)	£312.00	I	£312.00
		Total	£627.87

b) Landlord's forward estimate provision in respect of anticipated repairs beyond the initial period.

Details of Works	Estimated amounts (at current prices) of likely cost	I or B	Estimate of your likely annual contribution
Balustrade	£34.47	B	£17.24
Doors - entrance gate – steel	£8.27	B	£4.14
Drainage	£21.54	B	£10.77
Fencing/chain link	£2.98	B	£1.49
Guttering/P.V.C.	£22.64	B	£11.32
Line posts	£6.76	B	£3.38
Plumbing services/individual	£3.24	I	£3.24
Rain Water Pipe – PVC	£20.22	B	£10.11
Roof hatch	£4.60	B	£2.30
Roof pitched/concrete tiles	£129.03	B	£64.52
Roof/flat – concrete	£33.43	B	£16.72
Share paths & accesses/concrete Paving	£37.69	B	£18.85
Shared paths/accesses - Concrete - insitu (a)	£5.54	B	£2.77
Shared paths/accesses - concrete - insitu (b)	£3.25	B	£1.63

Walls – Render & pebble/wet dash	£185.97	B	£92.99
Walls/brickwork-pointing	£44.13	B	£22.07
		Total	**£283.54**

I = Individual items
B = Block items

The landlord will designate such funds as a reserve fund and apply the same accordingly.

NOTE
The estimated annual service and repair charges are the total of paragraph 7, 8a) and 8b)"

8. The section 125 notice went on to specify, once again as required by the 1985 Act, that the service charge would include certain works of improvements which were separately specified but which were a repetition of three items already contained within paragraph 8(a) of the notice. So far as concerns the columns headed "Estimated amounts (at current prices) of likely cost" these could have been more clearly expressed. By way of example, so far as concerns paragraph 8(a) of the notice, the estimated amount of likely cost was given as the yearly amount rather than as the total amount. Thus the right hand column told the Respondent of his likely annual contribution which, as regards for instance the first entry (Doors – entrance) was £108pa and this was an individual item, ie, an item specifically for the Flat (such that the Respondent was to pay the whole of the item) rather than an item for the Building (as regards which the Respondent was to pay half). Bearing in mind the estimate of the likely annual contribution was stated at £108 it is surprising that the estimated amount of the likely cost was also given at £108. A reference to Mr Gotts's dilapidations survey would reveal that (as amended in manuscript) in fact the present estimated cost of these works was £540 – and the £108 was obtained by dividing £540 by 5 ie the 5 representing the first five years of the lease. The Respondent was represented by solicitors in relation to his purchase of the long lease of the Flat. There is nothing before me to indicate that either the Respondent or the solicitors raised any questions regarding paragraphs 7 or 8 of the section 125 notice or how the two columns of prices were to be reconciled. While the document could have been clearer if it had stated the total sum for the estimated amount of the likely cost of each item, I consider that the document was an adequate notification to the Respondent of the contribution which the Appellant intended to seek for from him each year in respect of each item of proposed expenditure. Indeed the right hand column expressly states that the amount in question is the estimate of the Respondent's likely "annual" contribution.

9. By a lease dated 18 April 2005 the Appellant demised the Flat to the Respondent for a term of 125 years from that date. The lease defined the expression "any services" in clauses 3(2) and 4(3) as meaning:

> ".... Those services or costs specified in the Fourth Schedule hereto as may from time to time be varied by the Lessor under its powers contained in sub-clauses (g) and (h)

> of the Clause 6 hereof so far as the same are applicable to this Lease and the Premises in addition to those costs or estimated costs incurred or to be incurred by the Lessor in observing and performing the provisions of sub-clauses (1), (2) and (4) of Clause 4 hereof".

10. Clause 3(2) of the lease is central to this case and contained a covenant by the Respondent as lessee in the following terms:-

> "(2) to pay on demand to the Lessor at such times and in such manner as the Lessor shall direct a fair proportion (to be determined from time to time by the Lessor's Director of Housing) of the reasonable costs or estimated costs (including overheads) of any services incurred or to be incurred by the Lessor in observing and performing the provisions of sub-clauses (1) (2) (3) and (4) of Clause 4 hereof or as from time to time varied under the power in that behalf contained in sub-clauses (g) and (h) of Clause 6 hereof so far as such costs are chargeable to the Lessee by the Lessor under the provisions of Part III of Schedule 6 of the Act ..."

Clause 4(1) to (4) contained covenants by the Appellant that it would, inter alia, keep in repair (including decorative repair) the structure and exterior of the Flat and the Building and would ensure so far as practicable that "any services" (the definition of which is set out above) which were provided from time to time were maintained at a reasonable level and to keep in repair any installation connected with the provision of those services. These services included those matters listed in the Fourth Schedule.

11. On 11 May 2005 the Appellant sent to the Respondent an advice note showing the monthly contributions of service and repair charges which were sought from him. These stated that the total was £93.33 per month made up of £75.95 for repairs and the balance being for services (namely waylighting, insurance premium and administration – nothing in the present case turns upon these). It will be seen that the sum of £75.95 per month equates to £911.41 per year, which is the total of the sums notified to the Respondent under paragraph 8(a) together with 8(b) of the section 125 notice. Thus the monthly demand in respect of the cost of repairs was in exactly the same sum as the Respondent had been notified would be sought from him in the section 125 notice.

12. The Respondent was unhappy about this demand and pointed out that while he was a secure tenant he was paying a certain rent per month but that the service charges being demanded were substantial and appeared to be not so very much less than the rent he used to be paying. A dispute arose and the Respondent did not pay the service charges demanded.

13. The Appellant had notified the Respondent in the section 125 notice that the works it intended to carry out within the first five years included works to the steel windows and the entrance door and the internal store door. The Appellant's workmen were permitted by the Respondent to measure up for these works and they carried out the works in February 2006, the cost of these works being £2,234.24, these works being the 1st and 2nd and 14th contained within paragraph 8(a) of the section 125 notice. These works were satisfactorily completed.

14. By letter dated 24 February 2006 the Appellant notified the Respondent of the service and repair charges for the year commencing 1 April 2006 the monthly charge being £95.60 and the amount thereof attributable to repairs being £78.99. No explanation or argument or objection was raised in relation to the difference between this sum and the previous £93.33 and I do not dwell to consider it – it may be that the difference is caused by the inflation allowance referred to in paragraph 16B of the Housing Act 1985 Schedule 6.

15. By an application dated 1 May 2006 the Respondent applied to the LVT under section 27A of the Landlord and Tenant Act 1985 as amended for a determination as to the amount of service charge properly payable. He complained that he did not have sufficient details regarding what the charges were in respect of and he repeated his complaint regarding the comparison between his previous rent and the amount he was now being asked to pay by way of service charge.

16. Under cover of a letter dated 23 May 2007 to the Respondent the Appellant made a demand for the payment of service charge in the sum of £2234.24 in respect of the February works. It was expressly stated that this was not an additional demand or claim but was put forward in the alternative to the 2005 and 2006 demands which the Respondent had already received. The Appellant made clear that it contended that the demand for instalments of service charge in the service charge demands served for 2005 and 2006 were valid, but that the present demand was being served in case they were not.

17. The Appellant, as a matter of caution, on 29 May 2006 applied to the LVT under Section 20ZA of the LTA 1985 for an order dispensing with the consultation requirements in respect of the February works, in case there had been some obligation to consult which had not properly been observed. It may be noted here that on that aspect of the case the LVT decided in favour of the Appellant and concluded it was reasonable to dispense with the consultation requirements if applicable (paragraph 62 of the decision).

18. There was a hearing before the LVT attended by the Appellant and the Respondent. The LVT in summary reached the following conclusions:

(1) It decided that the terms of clause 3(2) of the lease did not permit the Appellant to set up a reserve fund against the cost of future repairs. In paragraph 29 the LVT stated:

> "In our view the reference is to costs or estimated costs incurred or to be incurred in respect of services which have been performed.
>
> Further, if we are wrong in this construction, we would hold that the words cover services identified as required (although not yet performed) but not a reserve fund for services which may or may not be required at some time in the future (albeit based on informed expert opinion as to what services are likely to be required in the future)."

(2) The LVT gave consideration as to whether the Appellant could succeed on the basis of some collateral contract (an argument which I was told the Appellant had not in fact ever advanced and which was not advanced before me) or whether the construction of Clause 3(2) could properly be wider than the construction favoured by the LVT by reason of the factual background against which it was executed including the terms of the section 125 notice. The LVT concluded that there was no collateral contract and that the background regarding the Right to Buy and the terms of the section 125 notice were not admissible because they constituted declarations of subjective intent.

(3) The LVT concluded (paragraph 54) that a reserve fund was reasonable in principle.

(4) In paragraph 63 and following the LVT considered the position if the Appellant was, contrary to the LVT's view, entitled to claim through the service charge for payments towards future expenses to be held in a reserve fund. The LVT went on to consider whether the amounts set out in the section 125 notice were reasonable (which was a necessary consideration having regard to section 19(2) of the Landlord and Tenant Act 1985). As regards all of the items referred to in paragraph 8(a) of the section 125 notice the LVT concluded that the amounts charged were reasonable. As regards the items included in paragraph 8(b) of the section 125 notice the LVT found all the items reasonable with the exception of the 4th, 10th, 11th, 12th, 15th and 16th items being respectively fencing/chain link; roof pitch/concrete tiles; roof/flat - concrete; share paths & accesses/concrete paving; walls - render & pebble-wet dash; and walls/brickwork-pointing. As regards these items the LVT stated:

> "as to other Items ... the [Respondent] says it is unreasonable for the [Appellant] to seek reserve fund contributions for these Items which are far in the future and, in any event, there is uncertainty on whether works will be required as there is no evidence of a defect or expectation of a defect.
>
> We find, from what we saw at our inspection, that in respect of ... [these items] ... there is no evidence of disrepair to suggest an anticipation of want of repair in the reasonably foreseeable future. The effect, in our view, is that it cannot be said that there is an identifiable prospect of want of repair, ascertainable in time, and any anticipation of a want of repair is so uncertain as to make the contributions sought by the Landlord unreasonable."

Statutory provisions

19. The Housing Act 1985 section 125 requires a landlord, where a secure tenant has claimed to exercise the right to buy and this right is admitted, to serve on the tenant a notice complying with that section. The notice is required to contain certain material. Subsection (4) provides:

> "Where the notice states provisions which would enable the landlord to recover from the tenant –
>
> (a) services charges, or
>
> (b) improvement contributions,
>
> the notice shall also contain the estimates and other information required by section 125A (service charges) or 125B (improvement contributions)."

Section 125A requires the landlord to include estimates for works in respect of which the landlord considers that costs may be incurred within the reference period including the tenant's likely contribution in respect of each item. Similar estimates are required in respect of proposed improvement contributions. Section 139 and Schedule 6 Part III paragraphs 16A to 16C make further provision in respect of the ability of a landlord to require the tenant to pay contributions in respect of services for repairs or for improvements. By paragraph 16B(2) the tenant is not required to pay in respect of works itemised in estimates contained in the section 125 notice any more than the amount shown as his estimated contribution in respect of that item together with an inflation allowance.

20. Section 19(2) of the Landlord and Tenant Act 1985 as amended provides:

> "(2) 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."

Appellant's submissions

21. In summary Mr Arden's arguments on the principal point of construction of clause 3(2) of the lease were as follows:

(1) The lease on its proper construction, having regard merely to the words used and leaving aside for the moment the additional consideration mentioned in subparagraph (2) below, is sufficiently wide to entitle the Appellant to claim through clause 3(2) payment in respect of estimated future costs to be incurred on items of repair which are predicted to be required in the future, but which are not yet required, and to hold such sums in a reserve fund.

(2) The lease should however not be construed merely on the wording used but against the factual background in which it was executed including the facts that

> this was a lease granted pursuant to the right to buy provisions of the Housing Act 1985 after a statutorily required notice under section 125 had been served by the Appellant being a notice making clear that there would be yearly charges for eventual future work in order to build up a reserve fund. Accordingly construing the lease against this factual background any ambiguity or doubt (which Mr Arden did not accept) should be resolved in favour of a construction permitting the building of a reserve fund.

Mr Arden developed those arguments as follows.

22. He pointed out that the words of clause 3(2) are in wide and general terms. He accepted that the word "reasonable" qualifies both "costs" and "estimated costs". As regards the "fair proportion" this was either 50% (in respect of charges for works to the Building as a whole) or 100% (in respect of works to the Flat). There had been no challenge by the Respondent or by the LVT to this apportionment. Against that background Mr Arden drew attention to the following words

> "to pay on demand to the Lessor at such times and in such manner as the Lessor shall direct a fair proportion .... of the reasonable .... estimated costs .... of any services .... to be incurred by the Lessor in observing and performing the provisions of ....."

He argued that this express reference to an ability to recover in respect of estimated costs of services to be incurred by the Appellant showed that the LVT's primary construction of the clause (namely that the Appellant was limited to charging in respect of services which have been performed) must be wrong.

23. Mr Arden further argued that once it is recognised that the reasonable estimated costs of services to be incurred in the future (ie not limited to services which have already been performed) are properly chargeable, then there is nothing in clause 3(2) to indicate that these services have to be done within some specified time period.

24. As to the method of charging, namely by a number of separate annual contributions towards the eventual estimated cost, Mr Arden drew attention to the opening words of clause 3(2) namely the requirement to pay "at such times and in such manner as the Lessor shall direct". This indicated that there was not a once and for all ability to charge the Respondent with the entirety of the Respondent's fair proportion of the estimated costs, but instead such fair proportion could be demanded in instalments over a substantial time period.

25. Mr Arden pointed out that the Respondent has a double protection regarding the reasonableness of what he is required to pay, namely the demand must be in respect of "reasonable .... estimated costs" (this is the protection afforded by the wording of the lease) and also "no greater amount than is reasonable" is payable (this is the protection provided by section 19(2) of the Landlord and Tenant Act 1985).

26. Mr Arden argued that in making the demands for the payment of service charges which the Appellant had made the Appellant was doing exactly what was allowed by the lease. The Appellant had estimated the reasonable costs to be incurred by the Appellant in complying with its repairing obligations. It had decided upon the appropriate times and manner in which the Respondent's fair proportion of these costs was to be paid. There was no suggestion that the estimated costs of the repairs was unreasonable.

27. Accordingly Mr Arden argued that the only proper construction, even if one looked solely at the wording of clause 3(2), was that the Appellant was entitled to charge through the service charge provisions for instalments towards future repairs and to hold such sums in a reserve fund. If however the foregoing was wrong such that a more limited construction as adopted by the LVT as its alternative construction (see paragraph 18(1) above) was permissible on the wording of the clause, then this narrower construction should not be adopted and the wider construction contended for by Mr Arden should be adopted because the former would be inconsistent with and the latter would be consistent with the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties at the date the lease was executed, in particular the background that the lease was being granted pursuant to the right to buy legislation and after the service by the Appellant of the statutorily required section 125 notice.

28. Mr Arden referred to *Investors Compensation Scheme Limited v West Bromwich Building Society* [1998] 1 WLR 896 and to the speech of Lord Hoffman at page 912 and following:

> "My Lords, I will say at once that I prefer the approach of the learned judge. But I think I should preface my explanation of my reasons with some general remarks about the principles by which contractual documents are nowadays construed. I do not think that the fundamental change which has overtaken this branch of the law, particularly as a result of the speeches of Lord Wilberforce in *Prenn v. Simmonds* [1971] 1 W.L.R. 1381, 1384-1386 and *Reardon Smith Line Ltd. v. Yngvar Hansen-Tangen* [1976] 1 W.L.R. 989, is always sufficiently appreciated. The result has been, subject to one important exception, to assimilate the way in which such documents are interpreted by judges to the common sense principles by which any serious utterance would be interpreted in ordinary life. Almost all the old intellectual baggage of 'legal' interpretation has been discarded. The principles may be summarised as follows:
>
> (1) Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.
>
> (2) The background was famously referred to by Lord Wilberforce as the "matrix of fact," but this phrase is, if anything, an understated description of what the background may include. Subject to the requirement that it should have been reasonably available to the parties and to the exception to be mentioned next, it includes absolutely anything which would have affected the way in which

the language of the document would have been understood by a reasonable man.

(3) The law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent. They are admissible only in an action for rectification. The law makes this distinction for reasons of practical policy and, in this respect only, legal interpretation differs from the way we would interpret utterances in ordinary life. The boundaries of this exception are in some respects unclear. But this is not the occasion on which to explore them.

(4) The meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean. The background may not merely enable the reasonable man to choose between the possible meanings of words which are ambiguous but even (as occasionally happens in ordinary life) to conclude that the parties must, for whatever reason, have used the wrong words or syntax. see *Mannai Investments Co. Ltd. v. Eagle Star Life Assurance Co. Ltd* [1997] A.C. 749.

(5) The 'rule' that words should be given their 'natural and ordinary meaning' reflects the common sense proposition that we do not easily accept that people have made linguistic mistakes, particularly in formal documents. On the other hand, if one would nevertheless conclude from the background that something must have gone wrong with the language, the law does not require judges to attribute to the parties an intention which they plainly could not have had. Lord Diplock made this point more vigorously when he said in *Antaios Compania Neviera S.A. v. Salen Rederierna A.B.* [1985] 1 A.C. 191, 201:

> 'if detailed semantic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business commonsense, it must be made to yield to business commonsense.'"

As regards paragraph 3 of Lord Hoffman's analysis Mr Arden argued that the LVT was wrong in viewing the section 125 notice as being inadmissible background on the basis of constituting the previous negotiations of the parties and their declarations of subjective intent. He pointed out that the section 125 notice was not a document constituting part of any contractual negotiation nor was it a statement of intent by a party as to what that party wished to see in a contract. Instead it was a statutorily required statement which would affect the rights of the parties including in particular regarding the recoverability of service charge having regard to the provisions of Schedule 6 Part III of the Housing Act 1985. In support of the proposition that the service of a section 125 notice was not part of any contractual negotiation he drew attention to *Bristol City Council v Lovell* [1998] 1 WLR 446 and to Lord Hoffman's statement at 453H to the effect that the right to buy provisions of the 1985 Act do not bring into existence a deemed contract – instead it misses out the contractual stage of normal conveyancing and

creates a statutory right to a conveyance. Mr Arden also drew attention to *Riverside Housing Association Limited v White* [2007] UKHL 20 as an example of the House of Lords construing the words of a tenancy agreement against the factual background. He also claimed further support for this approach from two Lands Tribunal decisions of the President, namely *London Borough of Brent v Hamilton* LRX/51/2005 and *Norwich City Council v Marshall* LRX/114/2007.

29. Mr Arden pointed out that the lease is known to have been granted, and on its face states that it is granted, pursuant to the right to buy legislation in circumstances where it was known that a section 125 notice had been served, as was statutorily required. Mr Arden further pointed out that Clause 3(2) of the lease expressly makes reference to the provisions of the Housing Act 1985 in the following words:

> "....so far as such costs are chargeable to the Lessee by the Lessor under the provisions of Part III of Schedule 6 of the Act"

The relevant provisions of Part III of Schedule 6 are the provisions of paragraphs 16A to 16C which make provisions limiting the extent that service charges can be charged by reference to the terms of the section 125 notice. Mr Arden argued that, unless the words of clause 3(2) are such as to preclude such a construction, the clause should be construed in a manner which reflects both (a) the commonsense of the situation (because of the good sense and reasonableness of having a reserve fund so as to avoid large and unwelcome and unprepared for expenditure in the future) and (b) the meaning which, when taking into account the factual background, the Appellant and the Respondent would reasonably have been understood to mean by the words used. This construction, namely a construction which permits a service charge to include a charge for contribution towards prospective future repairs by way of a reserve fund, is therefore the correct construction.

30. Mr Arden then developed the following argument supposing that the Appellant is successful upon the construction point and is entitled to establish a reserve fund for future estimated repair costs. In these circumstances he argued that the LVT was wrong in paragraph 67 of its decision in finding various items of charge to be unreasonable (see paragraph 19(4) above). He argued that the only reason given by the LVT for disallowing these items was effectively a return to their second construction of the clause (see paragraph 19(1) above) which denied the ability to set up a reserve fund at all. Once it is established that a reserve fund can be set up then, he argued, it inevitably follows that certain of the items (probably the most substantial and expensive items) will be items which will not be required to be done for a long time. However this very fact, namely that they may not be required to be done for a long time, should not be a reason for disallowing a charge towards such repairs as being unreasonable. He accepted that if the prospect was that the item in question would never require any works of repair of if the works of repair would be so distant in time as to fall beyond the end of the lease, then it would be unreasonable (supposing that the reserve fund was allowed in principle) to charge in respect of such items, but otherwise it would be reasonable to make some charge in respect of such items and the LVT was wrong to allow nothing for these items.

31. As regards the February works Mr Arden advanced the following argument. If service charge is properly payable in accordance with the reserve fund procedure argued for in his main argument, then the two demands for the 2005 and the 2006 service charges have already constituted a proper demand for payment (by instalment) in respect of these items and no additional demand for payment was needed for the purpose of section 20B of the 1985 Act. If however this was wrong and some additional demand in respect of the February works was needed within 18 months of the incurring of the costs of these works, then the alternative demand dated 23 May 2007 was a proper and valid demand. Mr Arden accepted that once this alternative demand had served its purpose, namely by acting as a valid demand for service charge in respect of the cost of the February works, the demand did not have the further function of making the Respondent liable to pay forthwith the entirety of these costs of the February works, because the recoverability of these costs remained limited by the Housing Act 1985 Schedule 6 Part III especially paragraph 16B – thus the Appellant would be limited to recover such payment through the instalments which had been notified to the Respondent in the section 125 notice. However the purpose of the alternative demand was to remove any possibility of the Respondent being entitled to argue (a) that the demands for instalments pursuant to the reserve fund regime were not valid and (b) that no valid demand for the cost of the February works had been made within the relevant 18 months period and (c) that therefore nothing whatever was payable in respect of these works, the benefit of which the Appellant had enjoyed.

Conclusions

32. I accept that on the proper construction of clause 3(2) of the lease the Appellant is entitled to demand from the Respondent payment of a fair proportion of the reasonable estimated costs of repairs to be incurred by the Appellant in the future in observing and performing the repairing obligations under the lease and that this is not limited to the cost of services which have been performed (which was the LVT's primary conclusion) nor is it limited to the cost of services which have been identified as already being required although not yet performed (which was the LVT's secondary conclusion if its primary conclusion was wrong). Subject to certain limitations mentioned below I therefore accept the argument that the Appellant is entitled to build up a reserve fund through the service charge against the estimated cost of future repairs which are not yet needed but which will be needed in due course. My reasons for so concluding are substantially those advanced in argument by Mr Arden and are as follows.

33. Clause 3(2) is notably brief. Obviously the ability to set up a reserve fund could have been made clearer by the introduction of an express provision, eg by declaring for the avoidance of doubt that the Appellant was entitled to charge sums to be paid into a designated reserve fund against repairs of an occasional or cyclical nature whether or not they were yet needed. However the mere fact that the matter could have been made clearer is not of itself a justification for concluding that the clause as it stands is insufficiently clear to permit the Appellant to set up a reserve fund. I accept that, as shown in *Gilje v Charlgrove Securities Ltd* [2001] EWCA Civ 1777 that the lease was drafted or proferred by the Appellant, that it falls to be construed *contra proferentem* and that where (as here) a landlord seeks to recover money

from the tenant there must, on ordinary principles, be clear terms in the contractual provisions which are said to entitle the landlord to do so.

34. I consider that the proper approach is not first to construe the words of the lease by looking solely at the words used without any reference to the admissible background and then asking whether the admissible background makes any difference. Instead I consider that the proper approach is first to identify the admissible background and then to construe the lease in the light thereof.

35. The admissible background in my judgment includes the following matters:

(1) The lease was granted pursuant to the right to buy provisions of the Housing Act 1985 (indeed this is clear on the face of the lease).

(2) The Appellant had served, in accordance with its statutory obligation to do so, a notice under section 125 on the Respondent. I accept that the section 125 notice should not be treated merely as some declaration of subjective intent on the part of the Appellant in the course of negotiations regarding the terms of the lease. Instead the section 125 notice was a statutorily required document which was intended to have (and which does have by force of statute) continuing legal effect after the execution of the lease. Also and separately clause 3(2) on its face provides that the Respondent's obligation to pay monies on demand in respect of, inter alia, reasonable estimated costs of services to be incurred is an obligation to do so "so far as such costs are chargeable to the Lessee by the Lessor under the provisions of Part III of Schedule 6 of the Act". These words indicate an intention that the Appellant should be entitled to recover service charge to the extent permitted (but not, of course, beyond the extent permitted) by the Housing Act 1985 Schedule 6 Part III, which limits the recoverable service charge by reference to the estimated amount shown in the section 125 notice.

(3) The building up of a reserve fund can be of advantage both to the tenant and the landlord, for the purpose of avoiding occasional large and unwelcome charges for substantial and as yet unfunded works. Also any such payments would be held on trust by the Appellant and the evidence was that interest would be earned upon and credited to the fund. Further, and importantly, the Respondent is protected by the fact that the sum to which he is being required to contribute in instalments is limited to "reasonable" estimated costs of services to be incurred (see the wording of clause 3(2)); also any amount which he is charged by way of service charge in advance of these works being carried out is limited to being "no greater amount than is reasonable" see section 19(2) of the Landlord and Tenant Act 1985.

36. I approach the question of whether clause 3(2) allows charging in advance and setting up a reserve fund without any predilection towards finding that such a charge is impermissible unless permitted by the clearest language.

37. Construing clause 3(2) in the light of the admissible background I conclude:

(1) The words are sufficiently wide to allow demands in respect of reasonable estimated costs in respect of services not yet incurred.

(2) There is nothing in clause 3(2) to indicate that these estimated costs must be incurred within any specific accounting year (there is no provision in the lease for accounting years) or within any particular time frame.

(3) The Appellant is not restricted to making a single once and for all demand for the fair proportion of such reasonable estimated costs which are to be incurred. The clause entitles the Appellant to demand payment "at such times and in such manner as the Lessor shall direct", and in my view this is sufficiently wide to entitle the Appellant to demand that the fair proportion of the reasonable estimated costs of future repairs be paid not in a single payment but in instalments. Section 19(2) would apply with the result that in respect of every demand "no greater amount than is reasonable is so payable".

(4) The extent of the ability to demand payment of such sums will be limited by the requirement that the Appellant can identify "reasonable ... estimated costs" of services "to be incurred". Thus the Appellant would not be permitted merely to decide that for a property of a certain type it was prudent to obtain £X pa as a round sum towards a reserve fund. The demands can only be justified if there has been a properly prepared reasonable estimate of thecosts of repairs to be incurred.

38. In the present case it does not appear to have been suggested by the Respondent (and it was not found by the LVT) that the amounts of any of the sums allocated to each individual future work of repair was unreasonable.

39. The LVT helpfully considered the recoverability of the various items making up the service charge supposing that, contrary to its conclusion, a charge for future repairs by way of a reserve fund was permitted. On this basis the LVT concluded that the amount charged in respect of all of the items referred to in paragraph 8(a) of the section 125 notice were reasonable but that the amount charged in respect of certain items in paragraph 8(b) of the notice were unreasonable and that no amount was reasonably payable in respect of those items. The LVT reached its conclusion on this aspect having inspected the premises and heard the evidence. It was entitled to conclude that any anticipation of a want of repair in respect of those items was so uncertain as to make the contributions sought by the Appellant unreasonable. I do not consider that this conclusion was reached on a wrong basis of law, namely by the LVT effectively (as Mr Arden argued) going back to advising itself that a reserve fund was not permitted. This analysis was expressly being undertaken by the LVT on the supposition that, contrary to its conclusion, a reserve fund was permitted. Nothing has been advanced to me which would entitle this Tribunal to interfere with the LVT's decision on this point. Further this is not a matter which is in any event open to the Appellant on their grounds of appeal.

40. The next question concerns the alternative demand for the payment of service charge in respect of the February works sent on 23 May 2007. I have not heard any argument as to the interplay between Section 20B and a system of demanding payment where the cost of works may be sought by way of yearly instalments but where the relevant costs may be incurred prior to all the instalments being paid (eg in the second year of the initial five year period). Nothing in this decision should be taken as a finding as to whether or not a demand under section 20B(1) or a notification under section 20B(2) was needed. However supposing such a demand or notification was needed, I see no reason for concluding that the Appellant's alternative demand was anything other than a valid demand for service charge in respect of the February works, being a demand served within 18 months of the relevant costs being incurred. Also the alternative demand can properly be construed as a notification to the tenant that relevant costs had been incurred in respect of the February works and that he would subsequently be required to contribute to these through the payment of service charge. I reject the LVT's conclusion that it is impermissible to serve a second demand for a payment where the demand is served on the basis that it is not accepted that the service of such a demand is required but the demand is served to guard against the possibility that it is required. In the field of landlord and tenant it is commonplace for a notice to be served by, say, a landlord on a tenant and, if the tenant disputes the validity of the notice, for the landlord to write back saying that it maintains this original notice was valid but, in case it was not, here is a further notice which will be relied upon in the event that, contrary to the landlord's argument, the first notice is held to be invalid.

41. Accordingly taking into account the original demands for service charge (based upon the annual contributions notified in the section 125 notice) and having regard also to the alternative demand, I conclude that section 20B has been satisfied in respect of the February works and accordingly section 20B provides no impediment to the recovery by the Appellant of the costs of the February works. However, as recognised by Mr Arden, the terms of the section 125 notice and the provisions of Part III of Schedule 6 of the Housing Act 1985 restrict the Appellant to recovering the costs of the February works by way of the annual contributions described in the section 125 notice rather than by way a lump sum payment of the entire amount.

42. It is noted that in paragraph 78 of its decision, in relation to the February works, the LVT observed that it did not have to deal with the following matters, namely:

(i) whether the costs were reasonable and reasonably incurred within section 19 of the Landlord and Tenant Act 1985;

(ii) the Respondent's submission that he had already contributed to these costs in the rent he had paid as a secure tenant.

The first of these observations by the LVT is puzzling in that the LVT had expressly found reasonable the amounts charged (by way of yearly contribution) in respect of the three items making up the February works in paragraph 66 of the decision. Bearing in mind this and the evidence which was before the LVT from Mr Gotts and the absence of any arguments to the contrary by the Respondent, I conclude that the costs of the February works were reasonable and that they were reasonably incurred. As regards the LVT's observation (ii), this submission on behalf of the Respondent has not been advanced before me and I am unable to see any basis

for it. Accordingly, I conclude that neither of the points mentioned by the LVT in paragraph 78 constitute any bar to the recoverability of service charge in respect of the February works in accordance with the contributions notified in the section 125 notice.

43. In the result therefore I allow the Appellant's appeal and I decide that the Appellant is entitled to recover service charges from the Respondent in accordance with the notifications dated 11 May 2005 and 24 February 2006 (referred to in paragraphs 11 and 14 above), save that there must be excluded from the service charges thereby notified the sums included therein for those items mentioned in paragraph 8(b) of the section 125 notice in respect of which the LVT concluded that no amount was reasonably payable, see paragraphs 18(4) and 39 above.

Costs and Fees

44. The LVT concluded that, as the Respondent succeeded before it on the main issue, the Appellant should reimburse the Respondent the whole of the fees paid by the Respondent in respect of the proceedings pursuant to Regulation 9 of the Leasehold Valuation Tribunals (Fees) (England) Regulations 2003. The LVT also concluded it was just and equitable to make an order in the Respondent's favour under section 20C of the Landlord and Tenant Act 1985 in respect of the costs incurred in connection with the proceedings before the LVT.

45. Before the Lands Tribunal the Appellant has succeeded upon all aspects of the case save for its challenge to the disallowance by the LVT of certain items in respect of which the demand was made. In these circumstances I conclude that it is wrong for the Appellant to be required to reimburse the above mentioned fees to the Respondent and I allow the Appellant's appeal against this part of the Order.

46. As regards section 20C, after certain initial argument Mr Arden was able, upon instructions, to undertake to the Tribunal that the Appellant would not seek to recover the costs of these proceedings, either in the LVT or before the Lands Tribunal, as part of the service charge for this Building but instead would only seek to recover such costs if and insofar as the Appellant was entitled to recover them from all the leaseholders under the right to buy leases as a whole. There are about 650 such leaseholders. The intention of the undertaking therefore is that there will no question that the Appellant will seek to recover the totality of the costs of these proceedings, both in the LVT and before the Lands Tribunal, from the Respondent alone but will limit the amount it seeks to recover from the Respondent to a fraction of such costs where the numerator is one and the denominator is the number of leaseholders holding on a long lease granted pursuant to the right to buy procedures (which is estimated to be about 650). On the basis of this undertaking, which limits the Respondent's exposure to costs to about $1/650^{th}$ of the costs incurred, I conclude it would not be just and equitable to make any order under section 20C and I allow the Appellant's appeal against the order made by the LVT under section 20C.

Dated 12 December 2008

His Honour Judge Huskinson