IN THE UPPER TRIBUNAL (LANDS CHAMBER)

Neutral Citation Number: [2019] UKUT 383 (LC)
Case No: LRX/81/2019

TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

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

LANDLORD AND TENANT – service charges – construction of lease – whether estimated half yearly service charge contributions due at the beginning of and half way through the relevant service charge year or half way through and at the end of the year – held: the latter, appeal allowed.

BETWEEN:

KINGSWOOD PROPERTY DEVELOPMENTS LIMITED **Appellant**

- and -

ASSETHOLD LIMITED

Respondents

Re: 55d Penge Road,
London
SE25 4EJ

Her Honour Judge Alice Robinson

The following cases are referred to in this decision:

Arnold v Britton [2015] AC 1619
Rainy Sky SA v Kookmin Bank [2011] 1 WLR 2900
Mannai Investment Company Limited v Eagle Star Life Assurance Company Limited [1997] AC 749

DECISION

Introduction

1. This is an appeal against a decision of the First-Tier Tribunal (Property Chamber) ("the FTT") dated 15 February 2019 in which it determined that the service charge sum of £634.17 is reasonable and became payable on 25 December 2017. It is not clear whether the figure should be £634.17 rather than £635.17 which has actually been paid but nothing turns upon that. Permission to appeal to the Tribunal was granted by Upper Tribunal Judge Elizabeth Cooke on 9 September 2019.

2. The appellant is the lessee of a ground floor flat known as 55d Penge Road, London SE25 4EJ ("the Flat") pursuant to an undated lease apparently made on 1 May 2008 between Money Face Limited as lessor and Richard Wellesley-Cole as lessee for a term of 125 years from 23 December 2006 ("the Lease"). The reversion expectant upon determination of the term of the Lease is now held by the respondent.

3. On 1 December 2017 the respondent demanded payment from the appellant of £635.17 said to include final service charges for the year 'December 2016/2017' and estimated service charges for the year 'January to December 2018' and said to be due by 24 December 2017. The appellant failed to pay and on 11 May 2018 the respondent issued proceedings in the Edmonton County Court to recover the service charges. The claim was transferred to the FTT to make a determination pursuant to s.27A of the Landlord and Tenant Act 1985 as to the amount of service charges payable. There were other claims and counter-claims between the parties which are not relevant to this appeal.

4. By the time of the FTT hearing on 17 January 2019 the appellant had paid the service charges of £635.17. The issue between the parties was whether that sum had fallen due on 25 December 2017 (as alleged by the respondent) or on 24 June 2018 (as alleged by the appellant). The FTT decision was issued on 15 February 2019 and held that the service charges in issue had fallen due on 25 December 2017.

The appeal

5. This appeal raises a short point of construction as to the correct interpretation of the Lease and in particular clauses 4(c)(ii) and (iii). The relevant provisions of the Lease are as follows. The reddendum in clause 1 reserves an annual ground rent payable by half-yearly payments on 24 June and 25 December in every year, "the first payment thereof being a proportionate part of the said annual sum due from the date hereof to the 23rd day of June next to be made on the date hereof." Clause 1 continues:

"**AND ALSO PAYING** by way of further or additional rent from time to time a sum or sums of money equal to one eighth of the amount which the Lessor may from time to time expend in effecting or maintaining the insurance of the Building against loss or damage by fire and such other risks (if any) as the Lessor may from time to time think fit in accordance with provisions of Clause 5(b) hereof such last mentioned rent to be paid without any deductions on the half-yearly day for the payment of rent next ensuing after the expenditure thereof and also paying by way of further or additional rent the Lessee's contribution in accordance with Clause 4(c) hereof."

6. By clause 3(a) the lessee covenants to pay the rents. By clause 5 the lessor covenants in sub-paragraph (b) to insure the building in which the Flat is located, in sub-paragraph (c) to paint the exterior and common parts of the building and in sub-paragraph (e) to carry out the works and pay the rates etc specified in the Fourth Schedule (which makes provision for carrying out repairs, redecoration, cleaning, lighting, payment of rates, insurance, fees and expenses).

7. Further provision for payment of service charges is made in clause 4(c) by which the lessee covenants as follows:

> "(i) Contribute and pay one eighth of the costs incurred by the Lessor in performing his obligations in accordance with Clause 5(b)(c) and (e) hereof;
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> (ii)The contribution under paragraph (i) of this clause for each year shall be estimated by the Managing Agents for the time being of the Lessor (hereinafter referred to as "the Managing Agents") or if none the Lessor (whose decision shall be final) as soon as practicable after the beginning of the year and the Lessee shall pay the estimated contribution by two equal instalments on the 24th day of June and 25th day of December in each year;
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> (iii)As soon as reasonable may be after the end of the year ending 24th December Two Thousand and Seven and each succeeding year when the actual amount of the said costs for the period ending on the 24th day of December Two Thousand and Seven or such succeeding year as the case may be has been ascertained forthwith pay the balance due to the Lessor or be credited in the books of the Managing Agents or if none the Lessor with any amount underpaid by the Lessee."

8. The FTT's determination is set out in paragraphs 21 to 28 of its decision:

> "21. The sole issue between the parties concerning the service charge is whether, on a true construction of the lease, the service charge in sum of £634.17 was payable on the date when the Claim was issued.
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> 22. By clause 4(c) of the lease, the respondent is required to contribute and pay one eigth of the costs incurred by the applicant in performing its obligations in accordance with clause 5(b)(c) and (e) of the lease.
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> 23. Clauses 4(c)(ii) and (iii) provide (emphasis supplied):

(ii) The contribution under paragraph (i) of this clause ***for each year*** *shall be estimated by the managing agents for the time being of the Lessor (hereinafter referred to as "the Managing Agents")… as soon as practicable after the beginning of the year* ***and the Lessee shall pay the estimated contribution by two equal instalments on 24th day of June and 25th day of December in each year.***

(iii)As soon as reasonable may be after the end of ***the year ending 24 December Two Thousand and Seven and each succeeding year*** *when the actual amount of the said costs for* ***the period ending on 24th December Two Thousand and Seven or such succeeding year*** *as the case may be has been ascertained forthwith pay the balance due to the Lessor or be credited in the books of the Managing Agent or if none the Lessor with any amount underpaid by the Lessee.*

24. The respondent contends that the first instalment of estimated service charge falls due on 25 June and the second on 25 December and submits that the words "for each year" should be interpreted as meaning each calendar year rather than each service charge year. Accordingly, on the respondent's case, the first instalment of the 2018 interim service charge did not fall due until 24 June 2018 and it was not outstanding when the applicant issued these proceedings in April 2018.

25. In response, the applicant submits that, given that the service charge year end is 24 December, it is clear that the first instalment of estimated service charge falls due on 25 December and the second on 24 June; if it were the other way around the second instalment would be due outside the service charge year. The lease does not state that the first instalment is due in June, it simply specifies the dates.

26. The applicant notes that it is common for the service charge machinery in leases to require tenants to pay, in advance, an amount on account of their service charge liability for each relevant accounting year. The contractual purpose of such a provision is obvious, namely to put the landlord in funds to discharge its obligations under the lease. After the service charge year has ended, the landlord knows how much has actually been incurred. The amount can be compared with the amount demanded on account and paid by the tenants, and a balancing exercise carried out to ascertain whether the tenants have underpaid or overpaid for that year.

27. The Tribunal was referred to Arnold v Britton and Others [2015] UKSC 36 at paragraph 15:

> *15. When interpreting a written contract, the court is concerned to identify the intention of the parties by reference to "what a reasonable person having all the background knowledge which would have been available to the parties would have understood them to be using the language in the contract to mean", to quote Lord Hoffmann in Chartbrook Ltd v Persimmon Homes Ltd [2009] UKHL 38, [2009] 1 AC, para 14. And it does so by focussing on the meaning of the relevant words, in this case clause 3(2) of each of the 25 leases, in their documentary, factual and commercial context. That meaning has to be assessed in the light of (i) the natural and ordinary meaning of the clause, (ii) any other relevant provisions of the lease, (iii) the overall purpose*

> *of the clause and the lease, (iv) the facts and circumstances known or assumed by the parties at the time that the document was executed, and (v) commercial common sense, but (vi) disregarding subjective evidence of any party's intentions.*
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> 28. The Tribunal accepts the applicant's submissions concerning the true construction of the lease and finds that the service charge claimed by the applicant in the sum of £634.17, which has been paid by the respondent, is reasonable and became payable on 25 December 2017."

9. The appellant submits that the FTT has fallen into error. Clause 4(c)(ii) requires the service charges to be estimated after the beginning of the year which the appellant submits means after 24 December. It cannot have been envisaged that the lessee should pay the estimated service charge in two instalments on 25 December and 24 June when the first instalment would be before the service charge had been estimated. Clause 4(c)(iii) specifically states the estimated charges are payable on 24 June and 25 December. In breach of this provision, the lessor's managing agents had estimated the service charges on 1 December, before 25 December. The first instalment of the estimated service charge was not due until 24 June, after the proceedings were issued. In contrast, clause 4(c)(iii) requires the ascertained service charge to be paid immediately after it has been ascertained after the end of the year ending 24 December. The appellant submits that on the respondent and FTT's construction, clause 4(c)(iii) would be otiose.

10. The respondent submits that the effect of clauses 4(c)(ii) and (iii) is to require the estimated service charge to be paid on 25 December and 24 June and you would expect both sums to be paid within the same accounting year. If the appellant's construction is correct, the second payment on 25 December would be in the next service charge period. A reasonable interpretation would be that the first payment would be at the beginning of the service charge year and the second payment half way through the year on 24 June. The appellant's interpretation is contrary to the express terms of the lease which shows a clear intent that interim payments be made. The respondent relies upon the speech of Lord Neuberger in *Arnold v Britton* [2015] AC 1619 paragraph 15 quoted by the FTT. In common with service charge machinery in leases which require a lessee to pay money on account, the estimated contributions are payable in advance on 25 December and 24 June and the balancing payment of actual costs for the period ending on 24 December is to be paid on demand thereafter.

Decision

11. As Lord Neuberger said in *Arnold v Britton* at paragraph 14, the House of Lords and Supreme Court have discussed the correct approach to be adopted towards the interpretation of contracts in a number of cases culminating in *Rainy Sky SA v Kookmin Bank* [2011] 1 WLR 2900. He then summarised the relevant principles in paragraph 15 in the passage cited by the FTT. However, in the context of this case it is worth noting what he went on to say in paragraphs 17 to 20 about commercial common sense:

> "17. First, the reliance placed in some cases on commercial common sense and surrounding circumstances (eg in Chartbrook [2009] AC 1101, paras 16-26) should not be invoked to undervalue the importance of the language of the provision which is to be construed. The exercise of interpreting a provision involves identifying what the parties meant through the eyes of a reasonable reader, and, save perhaps in a very unusual case, that meaning is most obviously to be gleaned from the language of the provision. Unlike commercial common sense and the surrounding circumstances, the parties have control over the language they use in a contract. And, again save perhaps in a very unusual case, the parties must have been specifically focussing on the issue covered by the provision when agreeing the wording of that provision.
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> 18. Secondly, when it comes to considering the centrally relevant words to be interpreted, I accept that the less clear they are, or, to put it another way, the worse their drafting, the more ready the court can properly be to depart from their natural meaning. That is simply the obverse of the sensible proposition that the clearer the natural meaning the more difficult it is to justify departing from it. However, that does not justify the court embarking on an exercise of searching for, let alone constructing, drafting infelicities in order to facilitate a departure from the natural meaning. If there is a specific error in the drafting, it may often have no relevance to the issue of interpretation which the court has to resolve.
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> 19. The third point I should mention is that commercial common sense is not to be invoked retrospectively. The mere fact that a contractual arrangement, if interpreted according to its natural language, has worked out badly, or even disastrously, for one of the parties is not a reason for departing from the natural language. Commercial common sense is only relevant to the extent of how matters would or could have been perceived by the parties, or by reasonable people in the position of the parties, as at the date that the contract was made. Judicial observations such as those of Lord Reid in Wickman Machine Tools Sales Ltd v L Schuler AG [1974] AC 235, 251 and Lord Diplock in Antaios Cia Naviera SA v Salen Rederierna AB (The Antaios) [1985] AC 191, 201, quoted by Lord Carnwath JSC at para 110, have to be read and applied bearing that important point in mind.
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> 20. Fourthly, while commercial common sense is a very important factor to take into account when interpreting a contract, a court should be very slow to reject the natural meaning of a provision as correct simply because it appears to be a very imprudent term for one of the parties to have agreed, even ignoring the benefit of wisdom of hindsight. The purpose of interpretation is to identify what the parties have agreed, not what the court thinks that they should have agreed. Experience shows that it is by no means unknown for people to enter into arrangements which are ill-advised, even ignoring the benefit of wisdom of hindsight, and it is not the function of a court when interpreting an agreement to relieve a party from the consequences of his imprudence or poor advice. Accordingly, when interpreting a contract a judge should avoid re-writing it in an attempt to assist an unwise party or to penalise an astute party."

12. In that case it was held that effect should be a given to the natural meaning of the wording of a service charge provision despite the fact that it had, in the event, resulted in an obligation to

pay a very substantial sum by way of service charge that bore no relation to the actual costs it was intended to cover.

13. By contrast, in *Rainy Sky*, Lord Clarke said that "If there are two possible constructions, the court is entitled to prefer the construction which is consistent with business common sense and to reject the other," paragraph 21. In that case there were two possible interpretations of a bank bond and the court preferred the construction which involved the most straightforward interpretation of the language used in one clause and accorded with commercial common sense even though, on that approach, it was difficult to see why a particular provision of the contract had been included at all.

14. The first point to note about the Lease is that although the reddendum in clause 1 appears to envisage that the insurance rent will be paid only after the relevant expenditure has been incurred ("on the half-yearly day for the payment of rent next ensuing after the expenditure thereof"), the provision immediately goes on to reserve as rent "the Lessee's contribution in accordance with Clause 4(c) hereof." Clause 4(c) is quite clear that, whatever its precise interpretation as to the time for payment of the estimated service charge, the estimated service charge includes insurance. Clause 4(c)(ii) refers to an estimate of the contribution payable under clause 4(c)(i) which in turn refers to the lessor's obligation to insure under clause 5(b) and payments made as provided for in clause 5(e) which includes the cost of insurance (Fourth Schedule, paragraph 4).

15. Despite this inconsistency in wording, neither party has sought to argue that the estimated service charge may not include the insurance rent. Indeed, of the £8,261.59 total estimated service charge for the calendar year 2018, £1,583.19 related to insurance. It could be said this is an example of the Lease's apparent intention to require estimated service charge payments in advance and commercial common sense enabling one to select between two potential meanings even though, on this approach, it is difficult to see that the provision as to the time for payment of insurance rent in clause 1 has any purpose.

16. The second point to note is that the reddendum requires the lessee to pay a proportionate part of the ground rent from the date of the lease to the 23 June next i.e. in advance. However, it does not require any payment in advance of the insurance rent or the additional rent by way of lessee's contribution i.e. the service charge. By virtue of clause 4(c), no payment for either of these sums by way of estimated contribution would be due until the first half yearly date for payment to fall after the date of the Lease, whether that is 24 June or 25 December. That applies whether the estimated contributions are due on 25 December and 24 June (the respondent's case) or are due on 24 June and 25 December (the appellant's case).

17. Turning to clause 4(c)(ii), the wording is quite specific. It states that the service charge for a particular year shall be estimated "as soon as practicable after the beginning of the year" (emphasis added). Although no year is specified, if it is treated as a calendar year (which appears to be envisaged by the service charge demand dated 1 December 2017), that means the estimated service charge for a calendar year shall be determined after 1 January in that year. If, by reference to clause 4(c)(iii), the year is to be treated as the year ending on 24 December, then again the

estimated service charge shall be determined after 24 December in that year, not before. That is consistent with the provision in clause 4(c)(ii) for half-yearly payment on 24 June and 25 December rather than on 25 December and 24 June.

18. In my judgment that interpretation would not be inconsistent with the clear intention of the Lease that estimated service charges be paid in advance. The 24 June payment would be half way through the year and, for example, the service charge demand shows that the insurance payment is made in the second half of the year and management fee incurred at the end of the year. Thus, half of those costs would be paid in advance. Further, although the 25 December payment would be paid the day after the end of the service charge year, for two reasons that would inevitably be well before the actual amount of service charges for the year had been calculated and demanded. First, clause 4(c)(iii) states that the actual amount of service charge costs is to be ascertained "as soon as reasonable may be after the year ending 24 December" i.e. not before and not, for example, on 1 December. Second, having regard to the Christmas holiday period and the time it usually takes to prepare final accounts, the date the actual costs are demanded could be months later.

19. If regard is had to commercial common sense, it could be argued that the estimated service charges would be payable at the beginning of and then half way through the service charge year i.e. on 25 December and 24 June, so that the lessor is in funds before any expenditure is incurred. However, in my judgment commercial common sense does not automatically mean that the lessor is to have all the cash flow advantage. On the respondent's construction, the lessee would have to pay all of the costs in advance before benefitting from any of the services and would have to fund the cash flow accordingly. By contrast, on the appellant's construction the lessor would have to pay some costs before being reimbursed but would also get some payment in advance and would be paid the full amount of the estimated service charge by the end of the service charge year and well before the final accounts were prepared and any balancing payment/credit became due.

20. Further, to adopt the FTT's construction does violence to the language of clause 4(c)(ii), again for two reasons. First, because contrary to the wording of the Lease, the service charge would have to be estimated well before the beginning of the year to allow time for the demand to be sent and allow a reasonable time for payment. Second, because it reverses the specified half-yearly payment dates from 24 June and 25 December to 25 December and 24 June.

21. I do not understand the appellant's submission that on the FTT's construction, clause 4(c)(iii) is otiose. If estimated service charges are to be paid in advance it is still necessary for there to be a calculation of actual costs and a balancing payment or credit. However, that does not detract from the clear wording of clause 4(c)(ii).

22. This is not a case where the parties have used one word or date(s) when they obviously mean another, such as Mrs Malaprop's reference to 'allegory' instead of 'alligator' (see *Mannai Investment Company Limited v Eagle Star Life Assurance Company Limited* [1997] AC 749, per Lord Hoffman at p.774). Nor in my judgment is it a case where there are two possible constructions and therefore the Tribunal is entitled to prefer that which accords with commercial common sense. The ordinary meaning of the language used clearly favours the appellant's

construction. Further, for the reasons already given, it is not clear that the respondent's construction is the one which best accords with commercial common sense.

23. To refer back to the points made in *Arnold v Britton* paragraphs 17 to 20 about commercial common sense, this principle should not be invoked to undervalue the importance of the language of the provision which is to be construed, or to search for drafting infelicities in order to facilitate a departure from the natural meaning, or retrospectively to reject the natural meaning of a provision as correct simply because it appears to be a very imprudent. In fact in this case, the natural wording of the Lease gives rise to a far less extreme or imprudent result than in *Arnold v Britton* and still means that there would be payment in advance of some of the service charges and all would be paid in advance of the ascertainment of the actual costs and the balancing payment/credit.

24. The respondent's submissions, which were accepted by the FTT, refer to a construction which is 'reasonable' and 'sensible' and seek to elevate a commercial advantage for the lessor rather than commercial common sense above the natural and ordinary meaning of the Lease, contrary to the principles in *Arnold v Britton* read as a whole.

25. For all these reasons the appeal is allowed.

Costs

26. Paragraphs 8 and 9 of the Grounds of Appeal refer to the FTT's decision on costs. However, no costs determination was made in the FTT decision dated 15 February 2019 and the Notice of Appeal does not refer to any costs decision. Further, it is not clear what determination was in fact made on costs or on what basis because the relevant costs decision has never been sent to the Tribunal. In consequence, the Tribunal is not in a position to deal with any costs orders made by the FTT.

27. As to the costs of the appeal, the parties attention is drawn to rule 10(2)(a) of the Tribunal Procedure (Upper Tribunal) (Lands Chamber) Rules 2010 (2010 No.2600) as amended and the very limited circumstances in which any order for costs may be made.

28. If either party wishes to make any representations as to costs they must do so in accordance with the accompanying letter from the Tribunal.

Her Honour Judge Alice Robinson

13 December 2019