**FIRST-TIER TRIBUNAL**
**PROPERTY CHAMBER**
**(RESIDENTIAL PROPERTY)**

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| **Case Reference** | **:** | **LON/ 00AC/LUS/2022/0005** |
| **Property** | **:** | **Barley House, 2 Peacock Close, London NW7 1LD** |
| **Applicants** | **:** | **Barley House Residences RTM Company Limited** |
| **Representative** | **:** | **Ms Chen, a director of the Applicant** |
| **Respondent** | **:** | **(1) Aviva Investors Ground Rent GP Limited**<br>**(2) Aviva Investors Ground Rent Holdco Limited** |
| **Representative** | **:** | **Ms Lyne of counsel** |
| **Type of Application** | **:** | **Application for a determination of the amount of any payment of accrued uncommitted service charges pursuant to s.94(3) Commonhold and Leasehold Reform Act 2002** |
| **Tribunal Members** | **:** | **Judge Prof R Percival**<br>**Mr R Waterhouse FRICS** |
| **Date and venue of Hearing** | **:** | **16 January 2023**<br>**10 Alfred Place** |
| **Date of Decision** | **:** | **19 January 2023,**<br>**revised 11 July 2023** |

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**DECISION**

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## The application

1. The Applicant seeks a determination pursuant to section 94(3) of the Commonhold and Leasehold Reform Act 2002 ("the 2002 Act") as to the amount of the payment of accrued uncommitted service charges held by the landlord or other party to the lease to the Applicant upon acquisition of the right to manage the property under section 94(1).

2. The relevant legislation may found at https://www.legislation.gov.uk/ukpga/2002/15/contents.

## The property and the parties

3. Barley House is a purpose built block of 20 flats. It is part of a wider estate. For the purposes of the lease, the Estate (as defined in the leases) consists of six blocks. The Respondent also owns two other blocks under a different Land Registry title number.

4. The Applicant is the right to manage company that acquired the right to manage the block on 11 April 2021. The tenants of one of the other blocks (Oat House) have exercised the right to manage.

5. The application is against the freeholders of the property, Aviva Investors Ground Rent GP Limited and Aviva Investors Ground Rent Holdco Limited.

6. Mainstay Group provide overall asset management services for the Respondent. HLM Property Management ("HLM") were the property managers before the acquisition date in respect of the property, and continue to manage those blocks on the estate that have not exercised the right to manage.

## The leases

7. We were provided with a specimen lease, on the understanding that all of the leases were to like effect. The term of the leases is 250 years, running from 2008. The leases have been varied in relation to rent, which is not relevant to this application.

8. The details of the Service Charge are provided in the fourth schedule, and in the opening definitions clause of the lease. The Service Charge is an estimated charge to cover the expenditure of the landlord in undertaking its obligations under the fifth schedule; "an appropriate amount" as a contribution to a reserve fund (defined as likely fifth schedule expenditure arising at more then one yearly intervals, such as exterior block decoration and repairs of the structure and conduits);

and a sum, including profit, in respect of administration and management of the Estate (defined by reference to a Land Registry title number to include the six blocks referred to above). The Service Charge is then to be reduced by the amount that the landlord intends to draw from the reserve fund during the service charge year. The final service charge is referred to as the Service Charge Adjustment, following a reconciliation resulting in either a further demand or a credit for the tenant.

9. The landlord covenants to carry out the Services, which are defined in relation the fifth schedule, in clause 5. The fifth schedule sets them out in detail. They include covenants to decorate and repair the structure, the Communal Areas (within the block), the Central Areas (the open parts of the Estate and the car park) and various other matters such as the costs of management, employing staff, insurance and so forth.

## The issues and the hearing

10. The Applicant was represented by Ms JBL Chan, a director of the Applicant. The Respondents were represented by Ms B Lyne of counsel.

11. HLM transferred a sum of £24,135 to the Applicant as uncommitted accrued service charges. The Applicant argued that a further £96,502 should be transferred. The Respondent accepted only that £169.28 further should be transferred.

12. In advance of the hearing, the Applicants indicated that their case related to four headings:

    (i) Deductions made from the reserve fund between 2015 and 2021;

    (ii) The (advance) service charge for the half-year commencing 1 March 2021 in general;

    (iii) The cost of repairs to heating installations in five of the flats in the Block; and

    (iv) Garden maintenance.

*The preliminary issue*

13. The Tribunal had circulated to the parties the case of *OM Ltd v New River Head RTM Co Ltd* [2010] UKUT 394 (LC), which did not feature directly in the hearing bundle. We suggested to the parties that this is the leading case on the application of section 94(3).

14. We considered that the interpretation of the effect of the case might be disputed, and that the determination of the issue would have a knock-

on effect on the evidence we should hear and the submissions we should consider. Accordingly, we invited submissions from the parties on the question to allow us to come to a decision on the question as a preliminary issue.

15. Ms Chan said that there had been cases after *OM Ltd*, and referred specifically to two First-tier Tribunal decisions, 46-130 Wheelwright House CAM/00KB/LUS/2020/0001 (4 March 2021) and 86 Blackheath Hill LON/00AZ/LUS/2021/0004 (6 April 2022). She quoted paragraph 19 of the former, which, after referring to *OM Ltd*, said

> The principal issue is to determine the amount of uncommitted service charge held by the respondent at the acquisition date. In the absence of a bank account for the relevant property, that sum has to be ascertained from the respondent's documents. Although the applicant may not pursue a s27A type challenge to payments made as a service charge, *it is entitled to test the respondent's evidence as to how it has calculated the sum due, including the calculation of any deductions*.

Ms Chan relied particularly on the passage in (the provided) italics.

16. Ms Chan laid particular emphasis on the fact that the service charge proceeds were held on the statutory trust under section 42 of the Landlord and Tenant Act 1987. She argued that where a breach of fiduciary duty, as a result of wrongful action by a trustee, took place, *OM Ltd* did not come into play. The Applicant's allegations were of actions that were in breach of the lease, not merely unreasonable in amount.

17. *OM Ltd* itself notes the importance of determining what accrued uncommitted service charges are "held by him", and that how broadly that should be interpreted would depend on the facts of the case (paragraph [23], quoted below). What was "held by" the Respondent at the acquisition date should be what would have been held by him, absent a breach of trust in handling the service charge accounts. To dismiss challenges based on (as here) the legality of deductions made from the service charge accounts was to condone illegality.

18. Ms Lyne started by noting that *OM Ltd* was the leading case and binding on the Tribunal, that the First-tier Tribunal decisions were not binding, and, she submitted, did not in any event contest the principle in *OM Ltd*.

19. The question in OM Ltd was whether section 94(3) provided another substantive remedy in respect to the use or reasonableness of service charges, or whether it was purely a procedural, accounting exercise? The RTM company in that case had sought to use it as the former, and

the First-tier Tribunal had agreed. The answer given by Judge Mole was that it was the latter. The Upper Tribunal judgment enjoined a strictly limited, factual enquiry as to what was held, not what should have been held, in the light of the history of dealing with the service charge accounts. Ms Lyne conceded that it might be that there would be what she described as a slim role for a Tribunal to deal with a clear case of dishonest removal of funds shortly before the acquisition date, but that was as far as it might go. A sustained enquiry into what should or should not have been in the service charge account was not warranted.

20. As to Ms Chan's emphasis on the section 42 trust, Ms Lyne said, first, that we had no separate jurisdiction to consider breach or otherwise of section 42. Further, we should not allow the section 42 trust to be used to reintroduce payability or reasonableness challenges to previous dealing with the service charge account by the back door.

21. Following an adjournment for consideration, we told the parties that we accepted Ms Lyne's submissions, and as a result would not entertain any substantive challenge, the effect of which was to argue that what should have been in the hands of the Respondent at the acquisition date rather than what was, as a matter of fact, in its hands. We said we would give reasons for our ruling in this decision, which we now do.

22. We first set out the terms of section 94 itself, to the extent they are relevant:

> (1) Where the right to manage premises is to be acquired by a RTM company, a person who is (1) Where the right to manage premises is to be acquired by a RTM company, a person who is –
>
> (a) the landlord under a lease of the whole or any part of the premises …
>
> must make the company a payment equal to the amount of any accrued uncommitted service charges held by him on the acquisition date.
>
> (2) The amount of any accrued uncommitted service charges is the aggregate of –
>
> (a) any sums which have been paid to the person by way of service charges in respect of the premises, …
>
> less so much (if any) of that amount as is required to meet the costs incurred before the acquisition date in connection with the matters for which the service charges were payable.
>
> (3) He or the RTM company may make an application to a leasehold valuation tribunal to determine the amount of any payment which falls to be made under this section. …

23. We consider that the key passage in *OM Ltd* is as follows:

> 23. The words of section 94 (1) are deliberately limited. The payment of accrued uncommitted service charges is confined

> to those accrued uncommitted service charges 'held by' the landlord or manager on the acquisition date. The natural meaning of those words is that what has to be paid is what the landlord or manager has actually got; not what he was entitled to have but failed to get or had at one stage but does not have now. Quite how broadly 'held-by-him' should be interpreted in any particular case will depend upon the facts of that case. In dealing with an argument that appears to have troubled the LVT, I would have little hesitation in deciding that such charges were 'held by him' within the section in a case where a manager had for his own reasons, dishonest or not, decided to put the service charges in cash in a box under his bed. That will be a matter for the LVT to determine under section 94 (3). Nor am I concerned that, as the LVT said, 'one can easily imagine devices by which managers who were in similar positions to the respondent could reduce assets to avoid payment to a RTM.' Managers could lawfully and properly reduce the payment by making sure they used the accrued service charges to make sure they had paid their suppliers what they owed them by the acquisition date. There would be nothing wrong with that. Apart from that, it is difficult to see how managers could lawfully and honestly, bearing in mind their position as trustees, reduce the payment. Indeed it is difficult to see why a rational and honest manager would wish to do so.
>
> 24. The sums must have been paid 'by way of service charges'. Those underlined words, to my mind, are there to make it plain that there is to be no argument so far as the payment is concerned about whether or not the charges are in fact justifiable and reasonable service charges; if they were paid 'by way of service charges' they are service charges for the purpose of section 94.
>
> 25. They also have to be uncommitted service charges, so if they have been paid or committed to a particular management debt or function they do not fall within section 94.
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> 26. Such a simple and limited objective, which does not seek to introduce new procedures or rights, seems to me to be eminently workable.

24. If "held by him" means "what the landlord or manager has actually got, not what he was entitled to have but failed to get or had at one stage but does not have now"; and sums paid "by way of services charges" mean that "there is to be no argument so far as the payment is concerned about whether or not the charges are in fact justifiable and reasonable", then clearly no level of unjustified diminution (or unjustified inflation) of a service charge account can be investigated, and taken into account, by us on an application under section 94(3). We do not think that even Ms Lynes' concession that proximate dishonest transfer would, logically, survive this approach. It is true that Judge Mole assumes

away even the possibility of a dishonest landlord or manager, but the logic of the passage is clear. It is difficult in principle to draw a distinction between diminution or inflation caused by a dishonest landlord and that caused by a manager who misinterpreted a lease, or did not turn his or her mind to the proper interpretation of the provisions of the lease. In any event, there was no allegation of dishonesty in this case.

25. We are less sure than Ms Lyne that the First-tier Tribunal cases cited by Ms Chan did not transgress the principle set out in *OM Ltd*, but it is not necessary for us to come to a view on that. It is *OM Ltd* that is binding on us, and once we have determined its correct interpretation, it is that that we must follow.

26. We understand the force of Ms Chan's submission that diminution of the fund may be a breach of trust, and that to ignore a breach of trust would be to condone it. But if we were to accept the submission, it would essentially invalidate the approach set out in *OM Ltd tout court*, as all service charge accounts are held on a statutory trust.

*The hearing*

27. As a result of this ruling, the objections as indicated by the Applicant in advance of the hearing fell away, as all relied on pre-acquisition date dealings in respect of the service charge that the Applicant sought to demonstrate were not in accordance with the lease, and had the result of diminishing what, on their case, *should have* been in the hands of the Respondent as accrued uncommitted service charges.

28. The Respondent's witness statement, which effectively stood as their statement of case, had been made by Mr Nicoll, Associate Director Asset Management at Mainstay, and Ms McBride, the Branch Manager of HLM. It had been intended that Ms McBride, who was closer to the everyday management of the Block, would give evidence at the hearing. She was unfortunately unavoidably unable to attend, and Mr Nicoll gave evidence in her stead.

29. During the course of his evidence, Mr Nicoll explained that Mainstay exercised a broad level of supervision of HLM's properly management of the Block. Mainstay would receive the service charge accounts and future demands in draft, and would give them what Mr Nicoll described as a cursory inspection. If there were significant spikes in expenditure or demands, discrepancies, or other matters that came to Mainstay's attention, they would challenge HLM to explain and justify them. That did not involve a line-by-line examination of the documents. Once satisfied, Mainstay would authorise the issue of the accounts or demands. Mr Nicoll said that he was not as closely acquainted with the figures as Ms McBride, and on occasions had to make assumptions on the basis of the accounts rather than having direct knowledge of the relevant matter.

30. Mr Nicoll explained that the Respondents' agents had prepared for the acquisition date by cancelling on-going contracts after the acquisition date, and undertaking an accounting process to prepare for the handover. Ms Lyne helpfully took Mr Nicoll through the key document for ascertaining the background to the calculation of the accrued uncommitted service charges made by the Respondents. That document was a "client statement" detailing transactions up to the day before the acquisition date. Mr Nicoll explained that this document was accurate, and much more manageable than a full bank statement, which would have included a great deal of extraneous material.

31. There was a single bank account for the Block, but there was technical provision within that account for HLM to segment it into a series of sub-ledgers corresponding to rent, reserve fund and the day to day property management fund. This explained the confusion (understandably) experienced by the tenants, who apprehended the sub-ledgers as separate bank accounts.

32. Mr Nicoll exhaustively explained both the way that the document worked, and how we could understand the outturn for the period. In the event, the technical detail of how the final figures were arrived at was not (at that technical level) contested, and we consider ourselves free to avoid going into the detail necessary to explain it here. It suffices to say that, at the end of the period (including the agreed payment – or rather, three payments – to the Applicant), there was a small sum in the carried forward column of £169.28 (once an anomalous entry for rent was subtracted). This figure represented that which the Respondents agreed fell to be additionally transferred to the Applicant. Mr Nicoll assumed that the sum arose either as a result of a miscalculation or an earlier assumption of an accrual that did not in the event arise, for some reason.

33. By way of clarification of one apparent issue, Mr Nicoll explained that management fees of £18,321.40 were paid during the period as a result of an earlier accidental oversight. At some point – Mr Nicoll thought three or four years ago – there had been a cash-flow pinch point, and HLM had put a stop on the payment of their own fees to free up more cash to pay contractors. As an oversight, the stop was never removed. Mr Nicoll explained that this was the gist of an explanation that had been given to him by Ms McBride recently. Mr Nicoll said that he assumed that invoices had been routinely raised, but the stop in the relevant software meant that they had not been paid. He also assumed that the oversight was overlooked as the deficit was dwarfed by HML's income from the rest of the Estate.

34. In cross examination by Ms Chen in respect of what appeared to be a duplicated payment of an invoice with one number, Mr Nicoll said that, having looked at the client statement, his belief was that the payments

were in fact two of a sequence of staged payments for a job, although he could only deduce that, and did not know what the job was.

35. In both cases, no doubt it was, in a general sense, helpful to the Applicant to have these explanations. However, even if no explanation could have been given, or the explanation had been that the payments had been made in error, we still could not have disregarded them in assessing what was "held by" the Respondent on the acquisition date. Such is the effect of *OM Ltd*.

36. Ms Chen did cross examine Mr Nicoll (with courtesy, and to good effect), but almost inevitably, all of her questions in truth were directed at whether deductions shown in the papers were justified or not, not to the narrow factual issue as to what was "held by" the Respondents allowed by *OM Ltd*.

37. In their final submissions, Ms Lyne essentially enjoined us to stick to our interpretation of *OM Ltd*, in the light of which no true challenge had been made in respect of the issue as it was identified in that case. Ms Chan effectively repeated aspects of her submissions on the preliminary issue, pointing to a number of uncertainties and concerns, all of which, however, went behind the factual issue of what the Respondent had in hand on the acquisition date.

38. The inevitable result of the way in which we consider ourselves compelled by authority to approach a determination under section 94(3) is that we find in all particulars for the Respondents.

39. *Decision:* The result is that we determine under section 94(3) of the 2002 Act that only the sum of £169.28 is held by the Respondents as accrued non-committed services charges.

*Application for the reimbursement of application and hearing fees*

40. The Applicant applied for an order that the Respondents reimburse the application and hearing fees.

41. In support of the application, Ms Chan argued that on the application form the Applicant had indicated its willingness for the matter to be determined on the papers.

42. Ms Lyne submitted that, in effect, the application should be decided on the balance of advantage of our determinations.

43. *Decision:* We refuse the application. Even if it is relevant whether the Applicant sought a paper determination, that there should be a hearing was ordered in the directions, and, in our view clearly correctly. It would have been close to impossible for the Tribunal to have

understood the documents provided without the assistance of oral evidence from Mr Nicoll, which also gave the Applicant the opportunity to cross-examine him on them.

44. More generally, while our discretion in relation to such an order is no doubt a wide one, there would have to be very exceptional facts to justify us making an order against a party that has been wholly successful, as the Respondents have been.

*Brief observations on the relationship between section 94(3) of the 2002 Act and section 27A of the Landlord and Tenant Act 1985*

45. As a consequence of the nature of the argument as to the proper import of *OM Ltd*, and further in the light of the intentions of the Applicant, there was some discussion at the Tribunal of the prospect of an application under section 27A of the 1985 Act in respect of the substantive challenges to the payability of service charges, which had been at the heart of the original application in this case. We note also that Ms Chan indicated that the Applicant had it in mind to make an application under section 27A in respect of whether another party, Vega Properties (No 3) Ltd, which was now the owner of the Central Areas, including the car park, could make service demands of the tenants of the Block.

46. In the light of those discussions, we consider it may be of assistance to the parties to make the following observations. It will be noted that these do not constitute determinations of any sort, and are in no way whatsoever authoritative of anything.

47. First, while it is true that there is no express restriction on who may make an application under section 27A, a finding against a landlord under the section can only be for the benefit of tenants. Given that, it is at least highly desirable that an application should be made by tenants and not by an RTM company, a separate legal person which cannot itself benefit from the application. There being, strictly, no issue between an RTM company and a landlord as to the payability or reasonableness of a service charge, a determination by a Tribunal on an application would not be binding between the landlord and the tenants who actually pay the service charge.

48. Secondly, we did indicate at the hearing that it might have been preferable if we had had a section 27A application before us in addition to the section 94(3) application. At one point, Ms Chan said that she (and, we take it, at least some of the other tenants) concluded that they should not make such an application, in the light of an observation in one of the First-tier Tribunal cases that it was better if the issues were decided separately. We do not think that there is necessarily a single answer to whether section 27A and section 94(3) applications in respect of the same properties, and in some reasonably close temporal relationship, should be heard together or not. An RMT company and

associated group of tenants might consider, however, that it might be better for both application to be made at the same time, so that the issue can be dealt with at the directions hearing.

49. Thirdly, although *OM Ltd* refers to section 94(3) as not providing an *additional* remedy, this case may illustrate circumstances in which the narrowness of the question as decided by that case means that there is no remedy (at least, as far as the Tribunal's jurisdictions go) at all. To posit a hypothetical (and we must not be taken as giving any opinion on the matter), the Applicant might be right that the payment of deficits in the in-year service charge accounts from the reserve fund was outwith the provisions relating to the reserve fund in the lease. On a section 27A application by tenants, there would be no consequences of such a finding. No service charge would have been demanded which was not payable or reasonable, because the effect of the (hypothetically) erroneous use of the reserve fund was only to save the tenants from paying an additional service charge that they would otherwise have been liable for. On the other hand, if the Respondents had (hypothetically) acted correctly, then at the acquisition date the RTM company would have been entitled to the transfer of the greater sum that would have been "held by" the Respondent in the reserve fund. On the other hand, under a section 27A application, the tenants may have the benefit of section 20B, and be relieved of an obligation they would otherwise have had.

*Review under Tribunal Procedure (First-tier Tribunal)(Property Chamber) Rules 2013, rule 55.*

50. Following the distribution of the original version of this decision, Ms Chan noted that we had erroneously stated that the acquisition date was 4 June 2021 rather than the 11 April 2021. It became clear to the Tribunal that this was not merely a typographical error, but that we had been under the impression that Mr Nicholl's evidence was that 4 June was the acquisition date, and that had been relevant to our consideration of the client cash statement referred to above.

51. The Applicant subsequently submitted an application for us to set aside the decision on the basis of this error. We declined to do so, on the basis that the preconditions in rule 51(2)(d) of the 2013 Rules was not made out. We did, however, decide to treat the application as an application for permission to appeal (under rule 56) in order to consider whether we should review the decision under rule 55. On 17 March 2023, we requested written submissions on the question from the parties. Unfortunately, thereafter the submissions were overlooked for a period as a result of an administrative oversight, for which we apologise.

52. The Applicant's written submissions effectively merely repeated points made earlier or raised irrelevant and/or new points.

53. The Respondent's written submissions, accompanied by a witness statement from Mr Nicholl, explained, first, that Mr Nicholl did not intend to suggest that the acquisition date was 4 June, and that if he did so, that was an innocent mistake. Secondly, he explained that the small number of payments made between the April and June dates related solely to already-committed expenditure in respect of management costs, and small sums relating to gardening and some other services.

54. In the absence of any cogent objection to these costs, we must consider them as being justified on the same basis as those for the immediately earlier period, for the reasons given above. We note again that the Applicant's objections were exclusively those which, as a result of *OM Ltd*, we cannot consider.

55. As a result, our review of this decision is limited to correcting the acquisition date in paragraph 4, providing this explanation, removing the normal section setting out rights of appeal, as we have refused the Applicant's (deemed) application for permission to appeal, and correcting a couple of minor spelling etc mistakes.

**Name:** Tribunal Judge Professor Richard Percival **Date:** 19 January 2023 and 11 July 2023