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Residential service charge consultation: who knows what the future holds

On Friday 21 December 2012, judgment was given in Phillips v Francis in the High Court. It could cause turmoil for those who manage residential service charge property.

The judgment can be found at http://www.bailii.org/ew/cases/EWHC/Ch/2012/3650.html.

As is well known, under section 20 Landlord and Tenant Act 1985, landlords of residential service charge property are required to consult with lessees prior to committing to qualifying works or a qualifying long term agreement. Failure to do so, without dispensation from the requirement, will result in the landlord not being able to recover from any lessee who contributes through their service charge to the cost of such works or long term agreement more than £250 (in the case of works) or £100 (in the case of a long term agreement).

Phillips v Francis concerns qualifying works (it concerned other matters too, but they are case specific and not of general relevance).

As a form of shorthand, one used to explain the consultation requirements as a process to be followed when major works were anticipated. In fact the works did not have to be that "major" for the consultation requirements to be triggered, but the point is that the common understanding was that low cost, low key works did not require prior consultation. The understanding was that if the nature and cost of the works proposed would not result in any single lessee paying more than £250 toward them, there was no need to consult. One considered the issue on the basis of each project of works proposed.

Although the judge in Phillips has concluded that past thinking about consultation, under a previous form of the legislation now in place, should be considered with caution, it is worth mentioning it, because it informed us all as to what property managers should do under the current regime (which came into effect in October 2003). In an attempt to avoid what was sometimes perceived as being the tiresome, time consuming and costly exercise of consulting, landlords and managers, when considering works to be undertaken, would sometimes contrive to split them up and try to treat them as separate projects, the cost of which would be low enough not to trigger the consultation requirements. In our experience, the same considerations were adopted after the new regime came in. But one often advised managers to be cautious and that such attempts might be considered contrivances. One also queried why consultation was so bad that it was to be avoided wherever possible.

In the meantime, low level, low cost, routine works were carried out without anyone considering that there was any need to consult. If one day an external downpipe needed repairing, it would just get done without much ado. Ditto changing some lightbulbs.

The Phillips case is being reported as determining that one should not consider works projects individually, but collectively over the service charge year. It decides that it is not the impact, in service charge costs terms, on a lessee as a result of an individual project one should be concerned about, but the impact of all of the works that might be undertaken in the whole service charge year. If, collectively, they will result in any lessee paying more than

£250 towards them, then consultation is required in relation to all of those projects, however minor they might be, assessed individually.

On a cursory review of some of the initial reports of the Phillips case, it might be thought to decide what many had believed the position to be, i.e. that if you had a project to do major works, it would not do to contrive to split it up to try to avoid consultation. However, even the initial reports caused one to wonder about one aspect of the decision as summarised – we revert to that below.

The relevant passages of the judgment are at paragraphs 20 to 37.

The way one can read the judgment (at least until and including paragraph 35) is that the judge was in fact referring to the qualifying works and by "the" he meant the works in relation to the specific project proposed, whatever that might be.

But then one reads paragraph 36. It seems inconsistent with paragraph 35, and is the cause for the increasingly adverse commentary.

With no appreciation of the irony of what he was saying when he asserts that there needs to be an application of common sense to the subject, the judge makes it clear that, when referring to the qualifying works in earlier passages of his judgment, he was referring, as it were, to all qualifying works during the service charge year, and says his construction of the current consultation legislation "conforms more closely to the ongoing works of repair and maintenance likely to be necessary on an estate in multiple occupation. They are unlikely to be identified as parts of a complete set of works which can be costed at the outset. In the normal way they will be carried out as and when required. The need for some limitation on an obligation to contribute is at least necessary with sporadic works of that nature as with a redevelopment plan conceived and carried out as a whole".

Some have said the decision is plainly wrong. It is difficult to disagree. One cannot deny that there is of course an argument supporting it (there is always something one can say to support an argument or other), but it just does not make sense. We have not gone back to Hansard (yet) to remind ourselves what was said by Parliament when it discussed the amendments to section 20 of the Landlord and Tenant Act 1985 (but we may have to), but that is partly because, for the moment, there is no point. A High Court judge has made a decision that stands as binding authority for county courts and leasehold valuation tribunals which are the venues for most residential service charge disputes, unless it is appealed (it is not clear there will be an appeal) or overturned by some other case or by legislation.

We noted earlier a point of concern arising on a reading of what was only a summary of the decision. The concern was about the idea that one considers the issue on an annual basis. The consequence of that, the judge suggests, is that if some of the works were carried out in a later year, then one considered the impact in costs terms to lessees afresh. He set out that view in paragraph 35 of his judgment, which was within that element of the judgment that, in isolation, could be considered to support the idea that one looks at the works one intends to carry out in that particular project. The concern about what the judge suggests is that it will encourage landlords and managers to be a little more creative (in an unhealthy way) about when they cause costs to be incurred as far as service charge law is concerned. That issue is considered differently by accountants. In service charge law, costs are generally incurred when they are paid (ultimately it depends on what the lease says). So by phasing payments more creatively, one could manipulate things to one's advantage, in the context of consultation. That said, there is a warning in OM Property Management Limited v Burr (Upper Tier, Lands Chamber January 2012, a case that concerned the limitation period effected by section 20B Landlord and Tenant Act 1985) that a delay in paying an invoice may cause it to be concluded that the cost had been incurred earlier, e.g. at the point the cost was invoiced, rather than paid.

We have wondered what practical advice could be given to landlords and managers. They have to accept that the Phillips case represents rather important, if unwelcome, authority to the effect that they are going to have to consider their budgets more carefully now and consult far more frequently. If they do not, and some might choose not to, they run the risk of challenge to costs incurred, leaving someone out of pocket. Indeed, lessees who wish to do so are likely to rely on it to challenge attempts to recover from them costs already incurred. Even if they have paid, the Leasehold Valuation Tribunal still has jurisdiction to hear them (section 27A (2) of the 1985 Act).

An option that occurs to us is to try and reduce the amount of consultation they have to do perhaps by entering into a long term agreement to provide qualifying works (for which consultation will be required, albeit of a separate nature) and then deal with the more limited requirements then imposed when one comes to propose qualifying works. This is a situation often encountered by lessees of Local Authorities. Another option might be, at the beginning of the service charge year when budgets are drawn up, to apply to the Leasehold Valuation Tribunal for dispensation (under section 20ZA of the 1985 Act) from the need to consult in relation to certain types or categories of work

We will be watching with interest the debate that has already started as a result of the judgment. Who knows what the future holds, but it would appear that the already complicated life of the property manager has just become even more tricky.

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