The burden of consultation

Legal notes James Driscoll considers a recent decision on service charges that could significantly increase the workload for landlords and managing agents

October will mark the 10th anniversary of the introduction of the current system for regulating service charge recovery in residential leases. This was brought in by amendments to the Landlord and Tenant Act 1985 (the 1985 Act) under Part 2 of the Commonhold and Leasehold Reform Act 2002. Before these changes, landlords were required, under section 20 of the 1985 Act, to obtain estimates and to consult with the paying leaseholders before carrying out works costing more than £1,000.

Since October 2003 there is a far more elaborate set of consultation requirements. Under the revised section, landlords should consult as required by the regulations (made under that section) if qualifying works are to be carried out and leaseholders will be required to contribute more than £250 to the costs as a service charge payment. Failure to do this caps recovery of service charges at that figure whatever, it seems, the landlord's costs in undertaking the works.

It is possible to apply to the leasehold valuation tribunal (and not, it appears, to the court) for an order dispensing with the consultation requirements (under section 20ZA of the 1985 Act). Those working in this field eagerly await the decision of the Supreme Court in the *Daejan* v *Benson* litigation on the scope of this power of dispensation.

Qualifying works

These are defined in section 20ZC as "works on a building or any other premises" – a very broad definition. What is the position if a landlord wants to carry out works in stages, or carries out various minor works in a particular service charge year? For years landlords and managing agents have dealt with this on a project-by-project basis. This approach, in part, follows a decision of the Court of Appeal in *Martin* v *Maryland Estates Ltd* [1999] 2 EGLR 53 on how to identify qualifying works (a decision on the previous version of section 20).

But this practice may have to be reconsidered in light of the recent decision in *Phillips* v *Francis* [2012] EWHC 3650 (Ch). The background is as follows: on a site in St Merryn, on the north Cornish coast, are some 150 chalets held on 999-year leases. The freehold of the site was sold and the new landlords (Mr and Mrs Francis), after discussion with the leaseholders, embarked on a modernisation programme. There was no consultation under section 20.

Key points

- What is the scope of "qualifying works"?
- The High Court has taken a different approach, which may lead to more expense

Although the modernisation plans met with approval by the chalet owners, the subsequent increase in their service charge was not welcomed. The chalet owners challenged the charges for 2008 (certified as £269,933.49) and 2009 (£583,542.87). Litigation ensued which has been protracted. Nearly three years ago the High Court decided, in a case involving these parties, that the 1985 Act service charge provisions apply to "holiday homes" (see *Phillips* v *Francis* [2010] 2 EGLR 31).

Leaseholder challenges

The leaseholder's complaints fell into two categories: first, whether the lease allowed for the freeholders to charge for their time in managing the site; and second, the effects of section 20 on the works that were carried out. They lost on both of the issues but won on appeal in both cases.

On the second issue, which is of far wider importance than the first, the parties agreed that there had been discussions about improving and modernising the site and its facilities and that in broad terms the chalet owners agreed with the proposed plans. In the absence of a section 20 consultation, how should the £250 be applied to the works?

The county court decided that the works did not amount to a single set of qualifying works to which the financial threshold should be applied; whether works are qualifying works or not is a question of fact, having regard to the nature and the extent of the works concerned. In this case the works were not part of one scheme but were different sets of qualifying works. Each part had, therefore, to be separately considered in terms of the statutory consultation requirements and the £250 financial threshold.

After hearing oral evidence, the court decided that some of the works attracted the financial threshold and others did not. It was influenced by the decision in *Martin* on how to identify qualifying works and disallowed a number of items as not recoverable under the leases; it decided the expenditure on the other items did not amount to a single set of qualifying works.

The High Court (the Chancellor) disagreed, saying: "I see nothing in the present legislation which requires the identification of one or more sets of qualifying works." If the planned works are "qualifying works", the landlord must consult or "face the consequences" and examine the costs and leaseholder contributions "on an annual basis".

This seems to mean that the landlord must consider year by year whether its expenditure will trigger the statutory consultation requirements. The High Court said that *Martin* concerned the relevant provisions before they were amended. The Chancellor added that continuing works of repair and maintenance are unlikely to be parts of a complete set of works that can be costed at the outset; they are more likely to be carried out when required and the consultation requirements will then apply. The case was remitted back to the county court for the costs of the qualifying works to be recalculated.

Implications of the decision

Landlords and managing agents planning works may have to consider a formal consultation over all aspects of the proposed works before entering into any contracts for particular phases. Such consultations may have to be undertaken each year. *Phillips* may have removed the project-by-project approach (following *Martin*) to qualifying works, replacing it with a requirement to consider all works when assessing the need to consult with leaseholders.

This may mean that landlords will have to consult each service charge year over any qualifying works if it is possible that the total cost will exceed the £250 threshold.

Not only will this increase, significantly in many cases, the work that landlords and their managing agents have to carry out, it will also lead to the additional costs being passed on to the leaseholders. When Parliament passed the amendments to the 1985 Act in 2002 one wonders if this was what was intended?

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