MAITLAND CHAMBERS CASE STUDY
Alan Johns – July 2009

Case Study: A Lease of a Shopping Centre requires each tenant to contribute a specified percentage to the service charge. Nothing is said about the charges having to be fair and reasonable. The Tenants are concerned that the charges are excessive and consider that other contractors could provide them more efficiently and cheaply. Is there anything they can actually do about this or are they just liable to pay whatever the services cost?"

I take it that we are concerned with leases of individual units in the centre.

There is some hope for the tenants. But that hope has its limits.

The hope lies in an argument for an implied term that the costs making up the service charge are reasonable.

It is a common misconception that the authorities establish that there will be no such implied term. The decisions in Havenridge Ltd v Boston Dyers Ltd [1994] 2 EGLR 73 and Bandar Property Holdings Ltd v Darwen (JS) Successors) Ltd [1968] 2 All ER 305 lie behind this misconception. Whilst they are decisions in which the Court declined to imply a term as to reasonableness, they were concerned not with service charge provisions but specifically with the recovery of the cost of insurance.

Finchbourne Ltd v Rodrigues [1976] 3 All ER 581 is a decision that did concern a service charge provision. It is this decision that founds a good argument for the shopping centre tenants.
The Court of Appeal considered a covenant by the tenant to contribute "a yearly sum equal to 4 per centum of the amount which the lessors shall from time to time have expended" in maintaining and running a block of flats. All 3 judges made clear their view that a term was to be implied that the costs be fair and reasonable. Cairns LJ said that, taking the strictest of tests for the implication of a term, "I am of opinion that such an implication must be made here. It cannot be supposed that the plaintiffs were entitled to be as extravagant as they chose in the standards of repair, the appointment of porters etc….In my opinion, the parties cannot have intended that the landlords should have an unfettered discretion to adopt the highest conceivable standard and to charge the tenant with it."

It is true that Finchbourne v Rodrigues concerned residential rather than commercial leases. But, the shopping centre tenants have a good chance of the same approach being applied to their leases of commercial premises. What are the factors pointing in that direction?

First, the Court of Appeal in Finchbourne v Rodrigues did not express their conclusion as relying on the fact that the leases were residential. And the reasoning of Cairns LJ would seem to apply also to commercial leases.

Second, many developments will be mixed use. Say, for example, a building with retail units on the ground floor and flats above. It would be an odd result if the Court were to find a different intention disclosed by the same words when considering the leases of the retail units on the one hand and the leases of the flats on the other.

Third, the authorities in support of the tenants' case do not end with Finchbourne v Rodrigues. Firstcross Ltd v Teasdale (1983) 265 EG 305 was a decision in which Neill J regarded Finchbourne v Rodrigues as establishing that "a variable contribution clause is, in any event, and as a matter of law, limited by a "fair and reasonable" condition." And in Morgan v Stainer [1993] 2 EGLR 73, David

Neuberger QC as he then was, sitting as a deputy judge of the Chancery Division, applied Finchbourne v Rodrigues in implying a term that legal costs recoverable as service charge must be fair and reasonable.

It is possible that the shopping centre tenants could put forward an alternative basis for the implication of a term, namely s.15 of the Supply of Goods and Services Act 1982. That section provides as follows:
"(1) Where, under a contract for the supply of a service, the consideration for the service is not determined by the contract, left to be determined in a manner agreed by the contract or determined by the course of dealing between the parties, there is an implied term that the party contracting with the supplier will pay a reasonable charge.
(2) What is a reasonable charge is a question of fact."
The argument would be that the lease contains a contract for the supply of a service, the consideration is not determined by that contract, and so a term is implied by s.15 that a reasonable charge will be paid.

My own view is that such alternative argument is unlikely to be successful. Section 15 does not operate so as to limit an otherwise agreed charge, it operates so as to supply a formula for fixing the charge where the contract is silent as to such charge. It is hard to see how a lease which has a formula for fixing the tenant's contribution by way of service charge can be regarded as silent as to the charge.

The same point was made by Evans J in Havenridge Ltd v Boston Dyers Ltd in respect of a covenant to pay the cost of insurance. In dealing with the submission that s.15 applied to such provisions he said: "In my judgment, section 15 does not create an implied term in the present case. The consideration given by the defendants for any service supplied by the landlord, clearly is "determined by the contract", and this is a sufficient ground, in my judgment, for rejecting the defendants' submission".

So there is some hope for the shopping centre tenants in that they have a good argument for an implied term as to reasonableness as a matter of construction, if not under s.15 of the Supply of Goods and Services Act 1982.

But there are limits to that hope.

The fact that other contractors may be able to provide the services more efficiently or cheaply is unlikely to be enough to establish a breach of any implied term that the service charge be fair and reasonable.

The question is of fairness and reasonableness. That is not the same question, for example, as to whether the service provided was the cheapest available.

That has certainly been the approach to landlord's repairing obligations, the cost of which is recoverable as service charge – see the discussion in Dowding & Reynolds, Dilapidations – The Modern Law & Practice at 10-07 & 10-08.

And it was the approach adopted in respect of service charge provisions by the Lands Tribunal in Forcelux Ltd v Sweetman [2001] 2 EGLR 173; the tribunal saying: "The question I have to answer is not whether the expenditure for any particular service charge item was necessarily the cheapest available, but whether the charge that was made was reasonably incurred".

So the shopping centre tenants should not think that it will be enough to show that there are better or cheaper contractors. They will need to go further. They should, of course, also scrutinise the charges for any arguments that the services to which they relate do not come within the recoverable items as specified by their leases at all.