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Universities Superannuation Scheme Ltd v Marks & Spencer plc

Court of Appeal

18 November 1998

Stuart-Smith, Thorpe and Mummery LJJ

Estates Gazette 30 January 1999[1999] 04 EG 158

Landlord and tenant - Service charges - Landlord's annual certificate of expenditure - Tenant's contractual liability for service charges - Whether service charge liability can be reopened after payment for relevant years - Whether certificate final and conclusive -- Whether landlord entitled to recover balance of service charges following miscalculation for earlier years

The respondent tenant held a lease for a term of 150 years from January 1987 of a retail store in a shopping centre; the appellant landlord held the reversion. The lease provided for the payment of service charges by the tenant, the amount being certified in writing annually by the landlord as soon after the end of the financial year as was practicable. Under the lease the annual certificate had to contain a summary of the expenses and outgoings of the landlord on services; the annual amount of the service charges was to be calculated by reference to the rateable value of the premises as a proportion of the aggregate of the rateable values of all the properties in the town centre benefiting from the services. The landlord's agents miscalculated the amount of the service charges payable by the tenant for the years ending March 1992 and 1993; the applicable rateable value of the premises was thought to be £348,600, whereas it was in fact £848,600. The landlord's claim for the balance of the service charges for these two years, based on the proper calculations, was dismissed by Blackburne J, who held that the tenant's contractual obligation to pay the service charges for any year in question was satisfied by the payment of the amount specified in the annual certificate. The landlord appealed.

***Held*:** The appeal was allowed. The contractual obligation of the tenant under the lease was to pay the service charges calculated in accordance with the terms of the lease. Payment of a lesser sum incorrectly calculated was not a performance by the tenant of its contractual obligation. The purpose of the annual certificate was to certify the landlord's annual expenditure; the certificate did not state the amount payable by the tenant. Under the lease the certificate was not expressly or by implication final and conclusive.

No cases are referred to in this report.

This was an appeal by the plaintiff, Universities Superannuation Scheme Ltd, from a decision of Blackburne J, who had given judgment on a preliminary issue in proceedings by the plaintiff against the defendant, Marks & Spencer plc.

Timothy Fancourt (instructed by Lawrence Graham) appeared for the appellant; John Furber QC (instructed by SJ Berwin & Co) represented the respondent.

Giving the judgment of the court at the invitation of Stuart-Smith LJ, **MUMMERY LJ** said: This appeal turns on the construction of the service charge provisions in a lease of a retail store forming part of Telford Town Shopping Centre. The lease was granted on 31 March 1987 for a term of 150 years from 19 January 1987. The original landlord was Telford Development Corporation. The freehold reversion is now vested in Universities Superannuation Scheme Ltd (USS), the appellant. The tenant is Marks & Spencer plc, the respondent.

Proceedings

On 29 January 1996 USS issued proceedings against Marks & Spencer claiming payment of a sum which, in the light of the judgment under appeal, is now calculated as amounting to £214,074.84, plus contractual interest. The basis of the claim is that, although Marks & Spencer paid the amounts of service charge demanded by USS for the years ending 31 March 1992 and 31 March 1993, it was later discovered that those amounts had by mistake been incorrectly calculated by the agents of USS, who made an error as to the rateable value of Marks & Spencer's premises. The calculation was on the basis of a figure of £348,600, whereas the applicable rateable value as at 31 March of each of the years in question was £848,600. Marks & Spencer denied liability to make any further payments in respect of those two years.

The essence of Marks & Spencer's defence, as disclosed in the pleadings and submissions, was that it paid USS amounts demanded by USS both by way of interim payment and the balance at the end of each of the years pursuant to the relevant provisions of the fifth schedule to the lease in respect of the service charges for those two years; that it had, therefore, satisfied its contractual obligation to pay service charges for those years; and that, on a true construction of the relevant provisions in the lease, there was no legal basis for any other claim for payment of the charges. Marks & Spencer denied that it was open to USS to require the further payments. It was originally pleaded that USS was estopped from requiring any further payments in respect of the two years, but the estoppel argument has not been pursued.

On 16 November 1996 Master Prebble ordered the determination of a number of preliminary issues. The only issue live on this appeal was framed in these terms:

> (a) as to whether the service charge years ending 31 March 1992 and 1993 can be reopened.

On 22 July 1997 Blackburne J heard the preliminary issues and among the orders he made was this:

> The plaintiff is not entitled to reopen the service charges in the years ending 31 March 1992 and 31 March 1993.

He granted leave to appeal.

Lease

The dispute turns on the true construction of the lease. It is therefore necessary to refer in some detail to the relevant provisions. The *reddendum* in clause 2.2.3, omitting immaterial parts, reads as follows:

> to hold the same unto the Tenant for the Term Paying therefor unto the Landlord throughout the Term the following sums:

> A sum payable without deduction or abatement whatsoever in respect of the Service Charge described payable and calculated in accordance with the Fifth Schedule hereto.

Clause 1 of the lease contains a series of definitions prefaced in clause 1.1 as follows:

> 1.2 In this Lease the following words shall where the context so admits have the following meanings:

Among the defined terms are "the Services" in clause 1.2.12:

> "the Services" shall mean the services specified in the Fourth Schedule hereto

And in 1.2.13:

> "the Service Charge" shall mean the sum payable by the Tenant to the Landlord for the Services in accordance with the Fifth Schedule hereto

Clause 3 of the lease contains the tenant's covenants as set out in detail in the third schedule. The first of those covenants, headed "Rent", reads:

> To pay the Rent (if demanded) and Insurance Premium and Service Charge in the manner specified herein without abatement or deduction

The critical provisions are the paragraphs in the fifth schedule, which is headed "Service Charge". Para 1 defines the landlord's financial year "in respect of which the account of the Landlord relating to the Telford Centre shall be made up". Para 2 relates to certification. It provides for annual certificates to be provided in writing by the landlord of the amount of the "Service Charge". It reads as follows.

> The amount of the Service Charge shall be certified in writing to the Tenant annually by the Landlord as soon after the end of the Landlord's Financial Year as may be practicable and in manner hereinafter provided ("the Service Charge Certificate")

There is no express reference in that paragraph to the amount of the service charge "payable by the tenant", nor is it provided expressly that the certificate given in writing by the landlord shall be binding, final or conclusive.

Para 3 relates to the *contents* of the certificate:

> The Service Charge Certificate shall contain a summary of all the expenses and outgoings incurred by the Landlord during the Landlord's Financial Year to which it relates for carrying out the Services

Para 4 relates to the *calculation* of the amount of the service charge payable by the tenant:

> The annual amount of the Service Charge payable by the Tenant shall be calculated by dividing the aggregate of the said expenses and outgoings incurred by the Landlord in providing the Services in the Landlord's Financial Year to which the Service Charge Certificate relates by the aggregate of the rateable values applicable at the end of each such year of all the premises at the Telford Centre which benefit therefrom and then multiplying the resultant amount by the rateable value of the premises at the same date

Para 5 relates to *payment* of the service charge by the tenant, both as to interim payments on account as demanded by the landlord and as to the sending out by the landlord to the tenant of the account of the service charge payable by the tenant with appropriate credits for interim payments. It also provides for the payment of the balance by the tenant. In view of the arguments presented on the appeal it is necessary to read this paragraph in full.

> The Tenant shall pay the Service Charge as follows:--
>
> 1. If demanded by the Landlord the Tenant shall pay on the first day of January the first day of April the first day of July and the first day of October in every year throughout the Term such reasonable sum on account of the Service Charge as the Landlord shall specify as an interim payment having regard to expenditure in previous years.
>
> 2. As soon as practicable after the date of the Service Charge Certificate the Landlord shall send to the Tenant an account of the Service Charge payable by the Tenant for the Landlord's Financial Year in question due credit being given therein for all interim payments made by the Tenant in respect thereof and upon the furnishing of such account there shall be paid by the Tenant to the Landlord the amount of the Service Charge as aforesaid or any balance found payable or there shall be allowed by the Landlord to the Tenant against the next interim payment any amount which may have been overpaid by the Tenant by way of interim payment as the case may require.

Para 6 may be omitted. Para 7 relates to challenges by the tenant to the service charge certificate within a specified time and on prescribed grounds.

> PROVIDED ALWAYS that subject to the Tenant paying the Services Charge in accordance with the provisions of the Schedule the Tenant may within forty-two days of receiving the Service Charge Certificate by written notice to the Landlord challenge the Service Charge Certificate on the grounds that the same contains an error or errors or on the grounds that the expenditure specified therein is excessive having regard to the provisions of this Lease or on the grounds that the Service Charge Certificate specifies expenditure not properly falling within the provisions relating to Service Charge herein contained and if the parties are unable to resolve any challenge by agreement then either party may refer the matter in dispute at any time to an independent surveyor...

Judgment

Blackburne J accepted the submissions of Marks & Spencer on the question of construction. They can be summarised as follows:

1. The tenant's contractual obligation is to pay the service charge payable and calculated in accordance with the fifth schedule.

2. Under para 2 of the fifth schedule the landlord informs the tenant of the service charge that is payable. That is done by the landlord stating the amount "payable by the tenant" in the certificate sent by the landlord to the tenant.

3. The tenant is under an obligation to pay the amount of the service charge specified in the certificate.

4. On payment of the amount so specified, the tenant satisfies his contractual obligations in respect of the service charge.

The judge rejected the contentions of USS that the sending of the account under para 2 was "mere machinery" and that it did not matter whether it contained an error or omission. He rejected the contention that the tenant's obligation was to pay the "correct" amounts, as distinct from the amount demanded by the landlord in the certificate. He rejected the contention that the tenant's obligation to make payment did not arise unless and until a demand was made specifying the correct sum.

The judge also rejected an alternative argument advanced on behalf of USS: that the obligation under para 2 of the fifth schedule was in the nature of an account resulting in a balance struck between a landlord and tenant and that, when struck, there was a settled account that equity allowed to be reopened in certain cases such as serious arrears. It is unnecessary to deal with that point, since it has not been canvassed on behalf of USS on this appeal.

Appeal

On the hearing of the appeal, counsel repeated in writing and developed orally the same submissions as they had made to Blackburne J. Both counsel focused on the question of whether Marks & Spencer had for the relevant years paid USS all the service charges that it was under a contractual obligation to pay. If Marks & Spencer had performed its contractual obligation by payment, then USS's claim must fail. If Marks & Spencer paid less than it was under an obligation to pay, then there is no defence by way of limitation or estoppel available to USS to claim for the shortfall. The critical question is: what is the service charge obligation of Marks & Spencer? The answer depends entirely on the construction of the relevant provisions quoted from the lease.

Purpose of service charge

The purpose of the service charge provisions is relevant to their meaning and effect. So far as the scheme, context and language of those provisions allow, the service charge provisions should be given an effect that fulfils rather than defeats their evident purpose. The service charge provisions have a clear purpose: the landlord that reasonably incurs liability for expenditure in maintaining Telford Shopping Centre for the benefit of all its tenants there should be entitled to recover the full cost of doing so from those tenants and each tenant should reimburse the landlord a proper proportion of those service charges.

Conclusion

Having regard to that purpose, I have reached the conclusion that the legal effect of the service charge provisions is as follows:

1. Marks & Spencer was under an obligation to pay the service charge "calculated in accordance with the Fifth Schedule"; that is

common ground. See the terms of the *reddendum* in clause 2.3.3, which, it is to be noted, does not refer to the service charge "certified" in accordance with the fifth schedule.

2. The method of *calculation* of the service charge payable by the tenant is contained in para 4 of the fifth schedule. That is the only paragraph in the schedule that refers to the process of calculation of the service charge payable by the tenant. The calculation of the service charge in accordance with that paragraph for the two relevant years produces a sum that substantially exceeds the calculation in fact made by the landlord's agents for those years. The payment of the lesser sum incorrectly calculated is not a performance by the tenant of the contractual obligation to pay the higher sum as correctly calculated. Marks & Spencer is therefore under an obligation to pay the shortfall to USS, unless there is some other provision in the fifth schedule that has a contrary contractual effect.

3. Marks & Spencer contends that para 2 produces a different effect. Mr John Furber QC, on behalf of Marks & Spencer, referred to para 2 as critical and as of primary importance to his submissions, and to paras 3 and 4 as of subsidiary importance only. The contention is that the effect of reading the definition of "Service Charge" in clause 1.2.13 into para 2 of the fifth schedule is to create an obligation on the tenant to pay the amount stated in the landlord's certificate. That is the service charge "payable by the tenant". Marks & Spencer paid the amount notified in the certificate for the two relevant years. It has, therefore, Mr Furber argued, performed its contractual obligations. There is nothing further that it can properly be required to do.

4. This argument is wholly dependent on the definition of "Service Charge" as the amount "payable by the tenant" as distinct from the amount actually expended by the landlord in relation to the service charge. The definition of "Service Charge" in 1.2.13 is a fragile foundation on which to construct this argument. The meaning in clause 1 to the definitions is expressly provided to be one where the context so admits. The context in para 2 of the fifth schedule does not so admit. Para 4 of the fifth schedule is the provision for the calculation of the service charge expressly stated in that paragraph to be "payable by the tenant". That expression is conspicuously absent from both paras 2 and 3. The reason for its absence is not difficult to fathom. The scheme, structure and context of the provisions in the fifth schedule indicate that the purpose of the certifying procedure in para 2 is to identify the total of the expenditure incurred by the landlord on the entire shopping centre in the relevant service charge year. The landlord certifies the amount of the expenditure in the certificate. Under para 3 the landlord must also include a summary of the expenses and outgoings incurred. The certificate does not state the amount "payable by the tenant" as service charge. It would be premature to do that in respect of an amount yet to be calculated under para 4 of the fifth schedule. Para 5 then proceeds logically to prescribe the machinery that applies for demanding interim payments, for sending out of accounts, for the payment of the balance and for making necessary adjustments.

I would reject the contention that the effect of the definition of "Service Charge" in 1.2.13, para 2 and para 5.2 of the fifth schedule determines the amount "payable by the tenant" as his contribution. Clause 2.3.3 and para 4 determine the amount of the contribution payable by the tenant.

5. Marks & Spencer also relies on para 7 as indicating that USS is not entitled to challenge its own certificate and "reopen" the years in question. The argument is that para 7 conferred only a limited right on the tenant to challenge a binding certificate. The limitation was as to the time within which a challenge could be made and as to the grounds on which a challenge could be made. It is argued that not even a limited right of challenge is conferred on the landlord and that what USS is seeking to do is not allowed under the terms of para 7 of the fifth schedule or under any other provision of the lease.

6. This argument is also fallacious. It rests on a misconceived assumption that the certificate referred to in para 2 of the fifth schedule is final and conclusive and that by para 7 the tenant is given a right to challenge that he would not otherwise have. But the certificate is not expressly or by implication final and conclusive. On the contrary, the effect of para 7 is to restrict the right that the tenant would otherwise have to challenge the contents of the certificate. There is no express or implied restriction on the right of the landlord to contend that the tenant has not paid the full amount of his contribution to the service charge. There is no restriction on the landlord's right to recover from the tenant the correct amount that the tenant is under an obligation to pay.

7. I would add that a possible source of the confusion in the arguments advanced by Marks & Spencer on the construction of the lease can be detected in the wording of the preliminary issue itself. The parties and their advisers may have seen the dispute about the service charge as one of "reopening" certified demands for past years and about whether USS could be relieved from the consequences of a mistake made by its agents. In legal terms, that is not the correct approach. The correct approach is to construe the lease in order to identify the nature and extent of the contractual obligation of the tenant to pay the service charge. The next step is to determine whether that obligation has been fully performed. It is important that preliminary issues are formulated with care and precision. Otherwise, the court may be asked the wrong question or may give the wrong answer because the question has not been correctly formulated.

I would allow this appeal.

THORPE and STUART-SMITH LJJ agreed and did not add anything.

Appeal allowed.