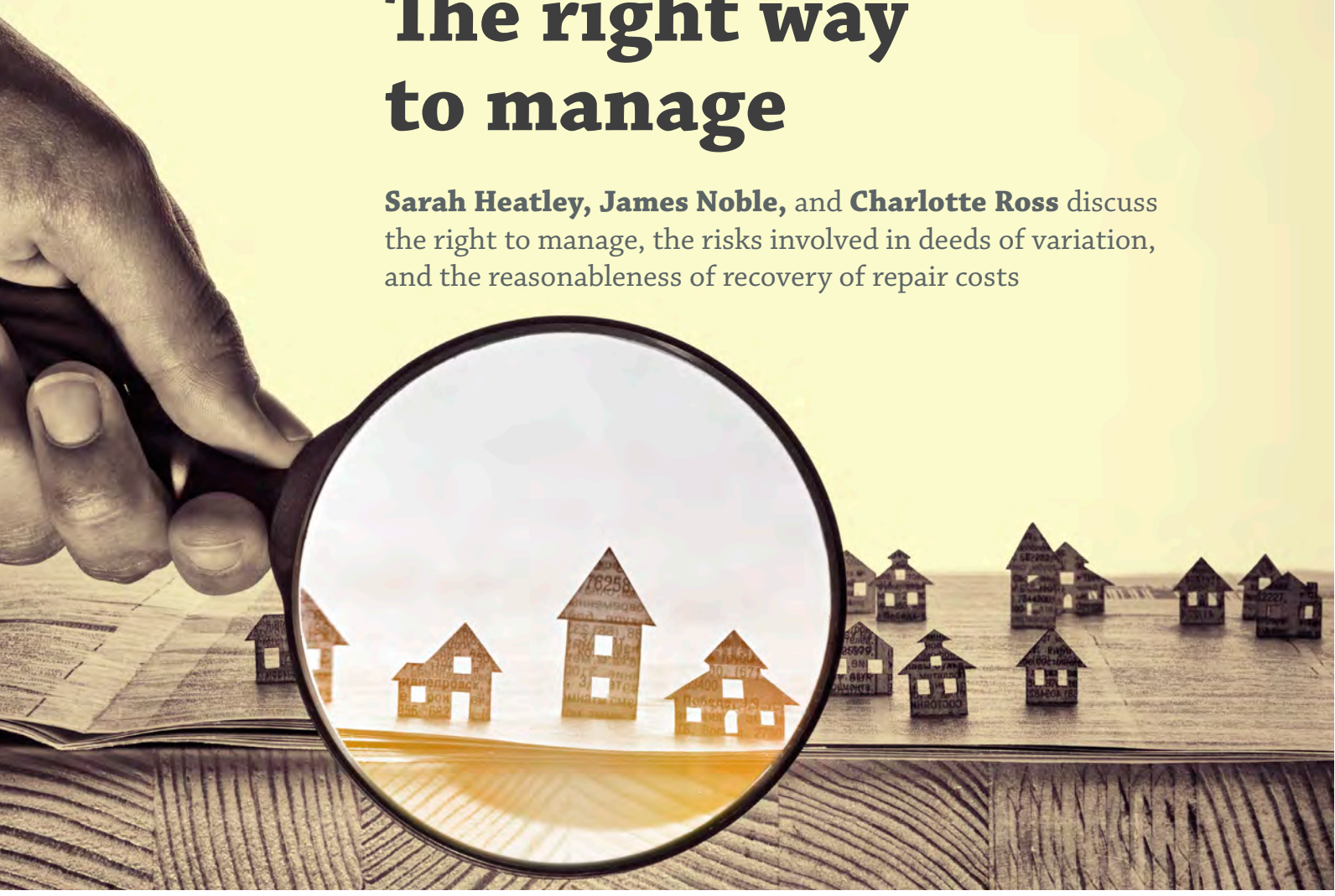
The right way to manage

Sarah Heatley, James Noble, and **Charlotte Ross** discuss the right to manage, the risks involved in deeds of variation, and the reasonableness of recovery of repair costs



Sarah Heatley, pictured, James Noble, and Charlotte Ross are solicitors at Forsters @ForstersLLP www.forsters.co.uk

The Court of Appeal has clarified the correct approach when parties fail to comply with right to manage (RTM) legislation in the recent case of *Elim Court RTM Co Ltd v Avon Freeholds Ltd* [2017] EWCA Civ 89.

As many practitioners will be aware, leaseholders of a building containing two or more flats have the right to take over management of that building from the freeholder, subject to certain limitations. Once participants have set up a RTM company and before they can serve the requisite notice of claim on the freeholder, the company must first give any leaseholders who are not already company members a notice of invitation to participate (NP). Fourteen days later, and if enough lessees wish to join, the notice of claim can be served.

While the Upper Tribunal ruled that Elim Court's claim failed due to several serious procedural errors, the Court of Appeal has elucidated as follows:

- The relevant legislation provides that an NP must give 'at least two hours on each of at least three days (including Saturday and Sunday or both) within the seven days following that on which the notice is given' when the RTM company's articles will be available for physical inspection (section 78(5)(b) of the Commonhold and Leasehold Reform Act 2002). Elim Court had not specified any weekend days in its NP but this was held to be a trivial failure which did not invalidate the NP.
- It was also held that the company's failure to serve its notice of claim on the intermediate landlord of a single flat who was unlikely to have any management responsibilities did not invalidate the NP.
- The notice of claim, which had been signed by a director of the company acting as RTM company secretary, was held to comply

with Companies Act requirements and, in any event, the consequence of non-compliance does not invalidate a notice provided it is signed by someone authorised by the RTM company.

This judgment makes clear that RTM claims should not be invalidated by minor mistakes and, interestingly, the Court of Appeal has called upon the government to simplify the RTM process – watch this space!

Risky business

Deeds of variation are handy tools in a solicitor's armoury. They have the power to change the parties' obligations and the path of the letting. However, if you are not careful, they could unintentionally change the terms of the lease so fundamentally that the law deems the lease as surrendered, with the parties creating a new lease on identical terms save for the variation – also known as a surrender and re-grant.

Unfortunately, this can happen all too easily. Seemingly innocuous variations may in fact increase the demise and/or the length of the term, which will trigger a surrender and re-grant. It's worth noting that a reduction in the rent or the demise will not usually mean a surrender occurs, but if they happen together this may comprise a surrender and re-grant.

There are significant potential risks to a landlord:

- Any existing guarantor(s) will be released;
- Previous tenants/guarantors will also be off the hook;
- If the original lease was an 'old lease' under the Landlord and Tenant (Covenants) Act 1995, then any original tenant liability will end and the lease will become a 'new tenancy'; and
- Even if the original lease was contracted out of the Landlord and Tenant Act 1954, the new lease will be protected, including rights of renewal or compensation at lease expiry.

Tenants should not take this lightly either as the newly created lease could give rise to an SDLT charge (depending on the rent and residue of the term). Overlap relief may apply if the original lease was granted after SDLT arrived in 2003. However, there could be liability for penalties and interest if the SDLT return is not submitted in time.

There are several factors to bear in mind in practice:

- If the client wants to extend the lease term, use a reversionary lease commencing on the expiry of the existing lease;
- If the parties want to extend the demise, a supplemental lease is required; and
- Remember that if two leases are created they should rise and fall together, so make sure the alienation and termination provisions are interlinked.

Being reasonably reasonable

There have been busy times in the Court of Appeal of late, where the concept of 'reasonableness' was considered in a case relating to the recovery of repair costs via a residential service charge.

The case of *London Borough of Hounslow v Waaler* [2017] EWCA Civ 45 concerned a flat in a tower block in Isleworth, which was let by the London Borough of Hounslow to Ms Waaler, a long leaseholder. The landlord was obliged to keep the structure and exterior of the flat in repair, and had the discretion to carry out improvements. In each case, the landlord could recover its costs via the service charge to the extent that they had been 'reasonably incurred'.

The landlord had carried out various works to the flat, including both works of repair and works of improvement. The service charge bill issued to Ms Waaler as a result of the works totalled £55,195.95.

The matter came before the Upper Tribunal which held that, in relation to the works of improvement, the requirement of 'reasonableness' obliged the landlord to take account of the extent of the tenants' interests, the views of the tenants, and the financial impact of the works.

The Court of Appeal upheld this decision. It acknowledged that the same legal test applied to both the works of repair and the works of improvement. However, in applying this test, the legal and factual context applicable to the category of works in question should be taken into account. It was relevant that it would not be possible for a tenant, at the point they take on the lease, to form any idea of the extent of their potential liability for the landlord's improvements.

The court noted that in assessing the financial impact of the works, the landlord was not required to investigate the financial means of the tenants. Instead, this required the landlord to assess the type of people who are its tenants. The court commented that leaseholders of flats in a luxury block in Knightsbridge may find it easier to cope with a bill for £50,000 than leaseholders of former council flats in Isleworth.

In giving its decision, the court did note that there is no bright-line difference between what is a repair and what is an improvement. In some cases, that line may be blurred. **SJ**

This judgment makes clear that RTM claims should not be invalidated by minor mistakes