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## CASE COMMENTARY

### **Daejan Investments Ltd v Benson [2013] UKSC 14, [2013] 1 WLR 854, [2013] 2 All ER 375**

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## INTRODUCTION

In this important case on the Landlord and Tenant Act 1985 (as amended by the Commonhold and Leasehold Reform Act 2002) the Supreme Court, by a bare majority, allowed the appeal against the decision of a Leasehold Valuation Tribunal (LVT) which had been affirmed by, first, the Upper Tribunal (Lands Chamber), and, secondly, by the Court of Appeal. Almost all long leases of flats contain an obligation on the landlord (or a service company) to provide services, such as repairing the exterior and common parts of the block, and a concomitant obligation on the tenants to pay service charges. The right of the landlord to recover such service charges depends on the terms of the particular lease, but the 1985 Act and the Service Charges (Consultation Requirements)(England) Regulations 2003 impose certain statutory requirements and restrictions on a landlord, which impinge on its ability to recover service charges. These requirements are designed to ensure that tenants of flats are not required (i) to pay for unnecessary services or services which are provided to a defective standard, and (ii) to pay more than they should for services which are necessary and have been provided to an acceptable standard.

## THE STATUTORY PROVISIONS

Section 19(1) of the 1985 Act provides that in determining the amount of a service charge the costs of qualifying works are to be taken into account:

“(a) only to the extent that they are reasonably incurred, and (b) ...only if the...works are of a reasonable standard.”

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Further, where the costs in any year would result in the service charge contribution of any tenant to the cost of the relevant works exceeding £250, the landlord cannot recover more than that sum unless, as provided by section 20(1) of the 1985 Act:

“ the consultation requirements have been either – (a) complied with in relation to the works...or (b) dispensed with in relation to the works...by (or on appeal from) a leasehold valuation tribunal.”

S 20ZA(1) provides that:

“Where an application is made to a leasehold valuation tribunal for a determination to dispense with all or any of the consultation requirements in relation to any qualifying works...the tribunal may make the determination if satisfied that it is reasonable to dispense with the requirements.”

The dispensation may be either prospective or retrospective. In practice it has hitherto been very difficult to persuade a LVT to dispense with any of the requirements prospectively, and almost impossible to do so retrospectively.

The consultation requirements are contained in Pt 2 of Sch 4 to the 2003 Regulations. They are in four stages:

### ***Stage 1. Notice of intention to do the works***

Details of the proposed works must be given to each tenant, allowing at least 30 days for observations (to which the landlord must have regard) and nomination of possible contractors.

### ***Stage 2. Estimates***

The landlord must seek estimates from, inter alios, nominees of the tenants.

### ***Stage 3. Notices about estimates***

The landlord must issue a statement to the tenants with two or more estimates (including any nominee's estimate) and a summary of observations and its responses. 30 days must be allowed for further observations, to which regard must be had by the landlord.

### ***Stage 4. Notification of reasons***

Unless the chosen contractor is a nominee or submitted the lowest estimate, the landlord must make its reasons available to each tenant within 21 days.

## FACTS

Daejan Investments Ltd (Daejan) was the owner of premises including five flats held on long leases by the five respondents. It proposed to carry out works costing over £400,000. It carried out Stages 1 and 2 of the consultation requirements but at the original hearing before a LVT it was concluded that the landlord had failed to comply with the stage 3 requirements in two respects. As Lord Wilson JSC put it, Daejan aborted the Stage 3 requirement and thus deprived the tenants of an opportunity to examine the tenders and make informed observations thereon. At a further hearing before the LVT the issue was whether the requirements should be dispensed with in relation to the works pursuant to the provisions contained in ss 20(1)(b) and 20ZA(1) set out above. If the landlord was free to enforce the service charge provisions in all the leases held by the five respondent tenants, it would be entitled to recover just under £280,000 in total from the respondents by way of service charge payments in respect of the works, whereas, if no dispensation was granted, it would be limited to recovering service charges of £250 per respondent in respect of the works, ie a total of £1,250. The LVT decided that it should not dispense with the requirements, and its decision was affirmed by the Upper Tribunal (Lands Chamber) and subsequently on a further appeal to the Court of Appeal. The LVT also rejected a proposal by the landlord that the chargeable amount should be reduced by £50,000: in the Court of Appeal Gross LJ doubted that the LVT would have been entitled to accede to this proposal, and in any event was entitled to reject it.

## ISSUES RAISED ON APPEAL TO THE SUPREME COURT

In the Supreme Court Lord Neuberger PSC, with whom Lord Clarke and Lord Sumption JJSC agreed, said that three questions of principle arose which needed to be answered before it could be decided how the appeal should be resolved. These were: (i) the proper approach to be adopted on an application under s 20ZA(1) to dispense with compliance with the requirements; (ii) whether the decision on such an application must be binary, or whether the LVT can grant a s 20(1)(b) dispensation on terms; (iii) the approach to be adopted when prejudice is alleged by tenants owing to the landlord's failure to comply with the requirements.

Lord Neuberger began his consideration of the first question by observing that the Act gave little specific guidance as to how a LVT should exercise its jurisdiction "to dispense with all or any of the [requirements]" in a particular case. The circumstances, he said, in which a s 20ZA(1) application is made are almost infinitely various, so any principles that can be derived should not

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be regarded as representing rigid rules. Taking account of the purpose of the requirements as noted above, he expressed the opinion that the issue on which a LVT should focus on an application under s 20ZA(1) is the extent, if any, to which the tenants were prejudiced by the failure of the landlord to comply with the requirements. In a case where it was common ground that the extent, quality and cost of the works had in no way been affected by the landlord's failure to comply with the requirements, he found it hard to see why the dispensation should not be granted (at least in the absence of some very good reason). In such case a dispensation should not be refused solely because the landlord seriously breached, or departed from, the requirements. The requirements are a means to an end, not an end in themselves. He did not consider it convenient or sensible to distinguish in this context, as the LVT, Upper Tribunal and Court of Appeal all thought appropriate, between "a serious failing" and "a technical, minor or excusable oversight", save in relation to the prejudice it causes. On the one hand a "minor or excusable oversight" could cause severe prejudice, and on the other hand a gross breach might cause the tenants no prejudice. The courts below had been right to emphasise the importance of real prejudice to the tenants flowing from the landlord's breach of the requirements: this is, indeed, normally the sole question for a LVT when considering how to exercise its jurisdiction. In agreement with the courts below, he held that the financial consequences to the landlord of not granting a dispensation is not a relevant factor. Lord Neuberger further stated that he did not agree with the courts below in so far as they supported the proposition that an additional reason for the imposition of the consultation requirements was to ensure a degree of transparency and accountability when a landlord decides to undertake qualifying works. In his opinion the obligations in ss 20 and 20ZA do no more than provide practical support for the two purposes identified in s 19(1).

On the second question the contention of the respondents was that a LVT has to choose between two simple alternatives: it must either dispense with the requirements unconditionally, or refuse to dispense with the requirements. If this contention was correct, then, as the Upper Tribunal held, and the Court of Appeal thought probable, it would not have been possible for the LVT to grant a dispensation on the terms offered by the landlord, namely a reduction of the sum payable by the respondents of £50,000. Lord Neuberger held, however, that a LVT is not so constrained when exercising its jurisdiction under s 20ZA(1): it has power to grant a dispensation on such appropriate terms as it thinks fit. Although a LVT has a very limited power to make an order for costs, the terms may include a condition as to costs – eg that the landlord pays the tenants' reasonable costs incurred in connection with the landlord's application for a dispensation. This condition would be a term on

which the LVT granted the statutory indulgence of a dispensation to the landlord, not a free-standing order for costs.

Lord Neuberger began his consideration of the third question by observing that where the landlord has failed to comply with the requirements, there may be a dispute as to whether, and to what extent, the tenants would relevantly suffer prejudice if an unconditional dispensation was accorded. The fact that this might occasionally involve a difficult exercise was not a valid reason for the court refusing to carry it out. He continued by saying that while the legal burden of proof – *semble*, proof that it was reasonable to dispense with the requirements – would be, and would remain throughout, on the landlord, the factual burden of identifying some relevant prejudice that they would or might have suffered would be on the tenants. However given that, *ex hypothesi*, the landlord will have failed to comply with the requirements, a LVT should view the tenants' arguments sympathetically; a further reason for such an approach is that the LVT is having to undertake the exercise of reconstructing what would have happened, and it is because of the landlord's failure to comply with its duty to the tenants that it is having to do so. For the same reason a LVT should be slow to deprive the tenants of the costs of investigating relevant prejudice, or seeking to establish that they would suffer such prejudice. And once the tenants have shown a credible case for prejudice, the LVT should look to the landlord to rebut it.

### **EFFECT OF CONCLUSIONS ON ABOVE THREE ISSUES**

Having set out his conclusions on the three issues raised, Lord Neuberger went on to explain their effect. A landlord who fails to comply with the statutory requirements must, he said, get a dispensation under s 20(1)(b) if it is to recover service charges in respect of the works in a sum greater than the statutory minimum. In so far as the tenants will suffer relevant prejudice as a result of the landlord's failure, the LVT should normally require the landlord to reduce the amount claimed as service charges to compensate the tenants fully for that prejudice. Concern that this could be unduly favourable to the landlord by enabling it to buy its way out of its failure to comply with the requirements is, he said, answered by the significant disadvantages which the landlord would face, ie having to pay (i) the costs of an application to a LVT under s 20(1)(b); (ii) the tenants' reasonable costs in connection with the application; (iii) full compensation for any relevant prejudice. The overall result would be, (a) the power to dispense with the requirements would be exercised in a proportionate way consistent with their purpose; (b) a fair balance between (i) ensuring that the tenants do not receive a windfall because the power is exercised too sparingly and (ii) ensuring that landlords are not

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cavalier, or worse, about adhering to the requirements because the power is exercised too loosely.

### **APPLICATION OF THE LAW TO FACTS OF THE CASE**

Applying the law as noted above Lord Neuberger said that all the courts below had adopted the wrong approach to the application for a dispensation. This was because (i) they took into account the gravity of the failure not only in the prejudice it may have caused to the tenants, but as a free-standing matter, (ii) they considered that the mere possibility of prejudice would be enough to preclude the grant of a dispensation, and (iii) in the case of the Upper Tribunal and the Court of Appeal they did not consider (or doubted) that it was open to the LVT to grant a dispensation on terms, and in the case of the LVT that they did not address the question whether the £50,000 reduction offered by the landlord exceeded any relevant prejudice which the tenants could establish. The correct question which the LVT should have asked itself was whether the respondents would suffer any relevant prejudice, and, if so, what relevant prejudice as a result of the landlord's failure, if the s 20(1)(b) dispensation was granted unconditionally. On the facts although there was an undoubted failure by the landlord to comply fully with the requirements, the relevant prejudice to the respondents of granting the dispensation could not be higher than the £50,000 reduction offered by the landlord. Accordingly the LVT ought to have decided that the landlord's application for a dispensation should be granted on the terms that (i) the respondents' aggregate liability to pay for the works be reduced by £50,000, and (ii) that the landlord pay the reasonable costs of the respondents in so far as they reasonably tested its claim for a dispensation and reasonably canvassed any relevant prejudice which they might suffer. The appeal was accordingly allowed and a dispensation granted on the terms indicated.

### **DISSENTING OPINIONS**

Both Lord Hope DPSC and Lord Wilson JSC gave strong dissenting judgments. Lord Hope attached great importance to the fact that the issues to which s 20ZA(1) directed attention had been entrusted by statute to an expert tribunal. Questions such as whether a landlord's breach of the consultation requirements was "serious" or "technical, minor or excusable" were questions of fact and degree best left to the tribunal. Further this was an area of tribunal law and practice where it had been recognised, out of respect for the tribunal's expertise, that judicial restraint should be exercised. Though it would normally be appropriate for the tribunal to require the tenants to provide some

evidence of prejudice (particularly in the case of a minor breach) there could, in his opinion, be cases where the breach was so serious that it would on that ground alone not be “reasonable”, as put in s 20ZA(1), to dispense with the consultation requirements. It should be, he said:

“open to the tribunal to take that view in the interests of preserving the integrity of the legislation, and to do so without conducting any such inquiry.”

Lord Hope further stated that he was unable to agree with the conclusion of the majority that the courts below had been wrong to hold that it should be open to the LVT to distinguish, in the exercise of its judgment, between breaches or departures according to their level of seriousness, without having first to consider the amount of prejudice they may cause or may have caused. Of course, he added, the two things may run together, but it would be not be right to hold that to separate the two can never be appropriate.

Lord Wilson expressly disagreed with central aspects of the exposition by Lord Neuberger of the principles to be applied by a LVT in its determination of an application to dispense with one or more of the consultation requirements. In his opinion when Parliament by the 2002 Act inserted the new s 20 and the additional s 20ZA into the 1985 Act and accepted the 2003 Regulations it deliberately imposed requirements which impacted severely on landlords. The dispensation is only available to a landlord if he satisfies the LVT that it is reasonable to grant it; even if so satisfied the LVT has a discretion whether to grant the dispensation; in the absence of compliance or dispensation the contribution of each tenant is limited to £250 whatever the cost of the works. Lord Wilson’s view was that substantial non-compliance with the requirements was, without more, intended to entitle the LVT, in the exercise of its discretion, to refuse to dispense with them in order to preserve the integrity of the legislation. This view, he said, was supported by a consultation paper in relation to a draft of the Regulations which stated that the intention of the dispensation procedure was to cover situations where consultation was not practicable and to avoid penalising landlords for *minor* breaches of procedure which do not adversely affect service charge payers’ interests. In Lord Wilson’s opinion Lord Neuberger’s conclusion that the gravity of the landlord’s non-compliance with the requirements is relevant to dispensation not of itself but only in so far as it causes financial prejudice to the tenant subverts Parliament’s intention. Again disagreeing with Lord Neuberger he agreed with the analysis of Lewison J in *Paddington Basin Developments Ltd v West End Quay Estate Management Ltd*<sup>1</sup> that one of the

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<sup>1</sup> [2010] EWHC 833 (Ch), [2010] 1 WLR 2735.

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reasons for the imposition of the consultation provisions was to ensure a degree of transparency and accountability.

Both the dissenting judges however agreed with the majority that it was open to a LVT to attach a condition such as that proposed by Daejan that it would reduce the cost of the works to be charged to the tenant by £50,000. The LVT's expressed reason for rejecting the landlord's offer of a reduction of £50,000 was that it was impossible to assess it in the light of the costs of the works already undertaken and of the estimated cost of the works still to be undertaken, as to neither of which had the landlord adduced evidence. The gravity of the landlord's non-compliance with the requirements made the LVT's appraisal of any offer extremely difficult. But, Lord Wilson said, with the full agreement of Lord Hope, that it was in any event entitled, in its discretion, to decline to accept the offered reduction without knowing the proportion which it bore to the overall cost of the works. In their view the LVT had made no error of law in refusing the landlord's application for dispensation with the requirements and the Upper Tribunal and the Court of Appeal had been correct in determining not to set its refusal aside. They would, therefore, have dismissed the appeal.

### COMMENT

As Gross LJ said in the Court of Appeal:<sup>2</sup> “The issue is one of statutory construction...” From what has been said above, it seems that the approach of the majority to the issue departed from the strict approach applied by the minority and the courts below. This is to the effect that non-compliance with the consultation requirements, in accordance with the terms of the statutory provisions, unless the requirements have been dispensed with by the LVT, has the consequence that costs incurred by the landlord above the statutory limit are irrecoverable through the service charge. This is so even if they had been reasonably incurred and had been incurred in the provision of services, or the carrying out of works, to a reasonable standard, and the tenant had suffered no prejudice. Lord Wilson, as noted above, in disagreement with the decision of the majority, was of opinion that where there had been a serious breach a LVT might properly hold that on that ground alone it would not be “reasonable” to dispense with the consultation requirements. He recognized that this might give rise to a windfall to the tenants and impact severely on the landlord, but considered that this severity was testament to the importance which Parliament attached to compliance with the requirements.

Lord Neuberger, on the other hand, giving the decision of the majority, was of opinion that one should look more deeply into, and lay more stress on,

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<sup>2</sup> [2011] 1 WLR 2320 at 59.



the reason for the imposition of the requirements, which in this case, as the minority agreed, was the protection of tenants in relation to service charges. In his view it was held to follow, as noted above, that normally the sole question for the LVT when considering whether it was reasonable to dispense with consultation requirements was the real prejudice flowing from the landlord's breach of the requirements. No distinction should be made between a "serious failing" and a "technical, minor or excusable oversight" save in relation to the prejudice it causes. A dispensation should not be refused by a LVT solely because the landlord seriously breached, or departed from, the requirements. It remains to be seen whether this more relaxed approach will be extended to codes imposing requirements to be fulfilled in other contexts.

The decision has met with a mixed reception, not surprising in a case where the voice of the bare majority in the Supreme Court, which must prevail, is in disagreement with all the other judges who have been involved in the case. Some applaud the approach of the majority which, in their view, produces a sensible result between, as Lord Neuberger put it, on the one hand ensuring that tenants do not receive a windfall because the power is exercised too sparingly and, on the other hand, ensuring that landlords are not cavalier, or worse, about adhering to the requirements because the power is exercised too loosely. Others consider that the purpose of Parliament was to protect long leaseholders from the doubtful practices of some landlords and they take the view that the decision is inconsistent with the integrity of the consultation process which is intended to deny relief to landlords who fail to follow the correct procedure. Its further intention is to ensure a degree of transparency and accountability.

Landlords have welcomed the decision, but they should not treat it as entitling them to disregard the consultation requirements. As noted above Lord Neuberger pointed out the landlord would have to pay not inconsiderable costs on the application for a dispensation. Landlords should, of course, comply with the consultation requirements, but if they have failed to do so they would be well advised to seek a dispensation, offering to discount the amount of the service by an appropriate amount to compensate the leaseholders for any prejudice arising from their failure to comply with the consultation requirements.