

## SERVICE CHARGES MINI GUIDE ISSUE 12



**With the economic climate remaining uncertain, service charges are continuing to give rise to tensions between landlords and their tenants. Tenants are scrutinising service charge accounts for unjustified costs and best value whereas landlords are more cautious about incurring costs unless recovery through the service charge is likely.**

### THE PROBLEM

- **Scope of Service Charge** – whether or not the cost of the service is recoverable will be determined by the provisions of the lease.
- **Sweeper Clauses** – sweeper clauses are often used to catch unforeseen costs such as those imposed by new legislation or technologies. However, landlords should approach these clauses with caution. The courts have tended to favour a strict interpretation and if a service charge clause contains a list of services which are to be included, the sweeper clause will be limited to the costs of the same type as those specified. In the recent Court of Session case of *Douglas Shelf Seven Limited v Co-operative Wholesale Society Limited*, the landlord attempted to rely on a sweeper provision which allowed recovery of “the professional charges of the landlords surveyors... in general in connection with the management and administration” to recover the cost of security services incurred by the manager of the property. The court refused to grant recovery; professional fees were properly chargeable but outlays incurred by those professionals not covered elsewhere in the service charge clause were not.
- **Test of Reasonableness** – where the service charge provisions specify a test of reasonableness, be sure to check whether it is just the costs of the work or the decision to do the work in the first place that needs to be reasonable.
- **Promotional and Advertising Expenses** – in a recent English case, *Boots UK Limited v Trafford Centre Limited*, the court were asked to determine whether entertainments, Christmas decorations, a Christmas grotto and a “Sky Wall” (a large TV screen which gave information about the shopping centre and its tenants) were included within the definition of promotion and therefore recoverable under the service charge. In deciding the case the court distinguished between something which was a promotion of the centre and something that was of

benefit to or an attraction within the centre. The decorations, grotto and entertainments all fell within the latter category and were not recoverable. The use of the Sky Wall specifically to display information about the centre was promotion and was recoverable.

- **Management Fees** – pay particular attention to the method of calculating these. In the recent English case of *St Modwen Developments (Edmonton) Limited v Tesco Stores Limited*, Tesco objected to a 10% management fee in circumstances where the lease provided that the amount of service charge was to be ascertained and certified. The court decided that the landlord was not entitled to the 10% figure in the absence of any investigation into the costs of providing the services in question.

### POSSIBLE SOLUTIONS

- **RICS Code of Practice: Service Charges in Commercial Property** – this guidance is voluntary and is not binding. However, it anticipates that “existing service charge clauses will be interpreted as far as possible in line with the principles and practices” set out in the code. The focus of the code is on ensuring that service standards are being delivered and that value for money is being obtained through transparency and better communication.
- **Sinking Funds and Advance Payments** – landlords want to have a fund available for one-off outlays, and want to have as much security as possible. Tenants do not want to hand over money in advance. The benefit of having a sinking fund is that a landlord always has money available to it before incurring any necessary but perhaps unexpected expenditure. In addition, the tenant is not faced with a disproportionately high service charge bill in any one year, so minimising the risk of tenancy insolvency. However, tax treatment of sinking funds, and the issues they can create when a building is sold, means that sinking funds are not often used.
- **Limitations and Exclusions** – it may be possible to agree, prior to work on a specific item being commenced, a cap on liability or exclusions for certain items of expenditure even where these are not specifically set out in the lease.
- **Court Ruling** – if there is sufficient doubt or disagreement between the parties, it would always be open to a landlord to obtain a ruling on liability for a particular service prior to the cost being incurred.

**For further information, please contact:**

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