

Liability of Service Charge after a flat is sold

Ask a hundred Property Managers what the rule is in relation to the question about standing service charge when a property is sold, and the chances are the vast majority will be of the view that the arrears pass to the new purchaser. **This is not necessarily the case!**

The fundamental question of whether a Landlord may claim service charge arrears from an assignee which accrued before the assignment takes place, is of fundamental importance to Property Managers. The law regarding the rights and liabilities of parties to a lease following an assignment, has been fundamentally changed in a number of respects by the Landlord and Tenant (Covenants) Act 1995 but those provisions are not retrospective. Accordingly, it is necessary to consider the position for:

- a) Old tenancies (granted before 1 January 1996); and,
- b) New tenancies (granted on or after 1 January 1996).

Liability of Assignee: Old Tenancies

One of the legal bibles "Service Charges Law and Practice" by Freeman, Shapiro and Slater states that an assignee is not liable for sums payable in respect of a period falling prior to the date of assignment. This is stated to be the case whether or not service charge is reserved as rent.

This view is shared by the editors of Woodfall *Landlord and Tenant* which states "in the case of continuing breaches (e.g. failure to repair) the assignee will in *practice* be liable for breaches which originated before the assignment to him but which have continued after that time. However, where the breach is complete before the assignment, the assignee is not liable. ... The same reasoning applies to instalments of rent, for failure to pay an instalment of rent on the due date is a breach which is complete when the rent is late and is not a continuing breach."

Woodfall refers to a number of old authorities, in particular *Grescott –v- Green 1700 and Churchwardens of St Savours Southwark –v- Smith 1762*. Property Managers may be forgiven for not being aware of the authorities set out in Woodfall as they are practically prehistoric! These authorities support the proposition that an assignee is not liable for a breach of covenant committed by the assignor if that breach is not a continuing breach. This position is accepted in number other textbooks including Megarry & Wade – *Law of Real Property*, Cheshire & Burn – *Modern Law of Real Property (16th Edition)* and Hill & Redman *On Landlord and Tenant*.

As a matter of principle, the conclusion is not really surprising. Prior to the assignment, the assignee has neither privity of estate nor privity of contract with the Landlord. There is no reason why he should be liable for the breach of another.

Failure to pay rent is a once and for all breach of covenant, so that where the service charge is reserved as rent in the lease, an assignee is not liable for service charge arrears accruing before the assignment. Where the service charge is not reserved as rent, failure to pay the service (will always become liable on a specific date) will be a once and for all breach of the covenant. It therefore follows that arrears of service charge accruing before an assignment are not recoverable from lessees as a debt.

Liability of Assignee: New Tenancies

In respect of new tenancies, we are delighted to report that there is no need to have recourse to antiquated case law. Section 23 (1) of the Landlord & Tenant Covenants Act 1995 provides:

“1. Where, as a result of an assignment a person becomes, by virtue of this Act, bound by or entitled to the benefit of a covenant, he shall not by virtue of this Act have any liability of rights under the covenant in relation to any time falling before the assignment”.

In short the assignee of a new tenancy is not liable to pay service charge arrears accruing before the assignment.

FORFEITURE

Old Tenancies

The conclusion that an assignee is not liable for arrears accruing before the assignment may seem surprising. If an assignee is not liable for arrears of service charge, why is it standard conveyancing practice for a purchaser of a flat to seek confirmation from the Landlord that the service charges have been paid? Furthermore, Section 4 Law of Property (Miscellaneous Provisions) Act 1994 implies into all assignments for consideration that all the rents to that date of the assignment have been paid and that other covenants and conditions have been performed or observed to that date and that the assignor has power to assign. Why imply such a covenant if the assignee is not liable for rent payable before the assignment?

The answer to this is that the lease continues liable to be forfeit. The paragraph in Woodfall cited above continues:

“These principles concern that personal liability of the assignee. But in addition to a personal remedy against the assignee, the Landlord is usually entitled to the proprietary remedy of forfeiture for breach of covenant. In order to exercise his remedy, the Landlord need only establish a breach of covenant or condition; it does not matter who has broken it. Accordingly, even where a breach of covenant is complete before the assignment, the Landlord will be entitled, as against the assignee, to forfeit the lease unless the right to forfeit has been waived in the meantime. The assignee will usually be required to make good the breach as a condition of relief against forfeiture, with the result that the Landlord may have an indirect means of enforcing the covenants against him even in respect of the breaches which were complete before the assignment.”

Relief from Forfeiture

Put crudely, the point being made in Woodfall is that even if the assignee cannot be sued for the arrears directly, as long as the Landlord does not waive the breach, it does not matter. The Landlord can forfeit and he will get the arrears from the assignee as a term of the Court granting the tenant relief from forfeiture.

Rent

In a 1930's case, the assignee argued that he should not have to pay arrears of rent which accrued before the assignment has a term of relief. The Court rejected that argument and made payment of the arrears a term of relief.

This case is based on the provisions of Section 212 Common Law Procedure Act 182 (check the date) which govern relief from forfeiture in the High Court for non-payment of rent. Nowadays, save for in exceptional circumstances, forfeiture claims for rent arrears should be brought in the County Court (CPR553) and in the County Court relief from forfeiture based on rent arrears is governed by the County Courts Act 1984 Sections 138 - 140. Although it is not 100% clear cut, there does not appear to be any meaningful difference between the statutory schemes, so that the assignee should be required to pay all of the rent arrears, including service charges expressed to be recoverable as rent (whenever accruing) as a condition of relief.

Not Reserved as Rent

Where the service charge is not reserved as rent, relief from forfeiture is governed by Section 146 (2) of the Law of Property Act 1925 under which the Court has a wide discretion to impose such terms as it thinks fit. The Court of Appeal has held that there is no difference in principle regarding the exercise of the Court's Discretion in granting relief in a rent case and in a service charge case. Accordingly, it is strongly arguable that even if the service charges are not reserved as rent, the assignee should have to pay the service charge arrears accruing before the assignment as a condition of relief.

New Tenancies

It is however, less clear whether the position is the same under a new tenancy. Section 23 (1) of the 1995 provides that an assignee has no "liability" under the service charge covenants "in relation to any time falling before the assignment". Thus it could be argued that he cannot be required in any circumstances to pay arrears accruing before the assignment even as a condition of relief. The counter-argument is that in this respect Section 23 (1) did not change the law. The assignee's "liability" in the sense of personal liability is the same under an old tenancy as under a new tenancy. Nothing in Section 23 expressly seeks to change the law of forfeiture and one would expect express provision for such a radical change. It is fair to say that this is a difficult point and has yet to be tested.

The Brethertons view is that a Landlord would still be entitled to forfeit and would still therefore be able to obtain the service charge arrears as a condition of relief.

Housing Act 1996

A further problem which arises is that forfeiture on the grounds of non-payment of service charge (whether reserved as rent or not) is governed by Sections 81 and 82 of the Housing Act 1986. These Sections were amended by the Commonhold and Leasehold Reform Act 2002 with effect from 28 February 2005.

As from 28 February 2005 Section 81 (1) states:

"(1) A Landlord may not, in relation to premises let as a dwelling, exercise a right of re-entry or forfeiture for failure *by a tenant to pay a service charge or administration charge unless –*

(a) it is finally determined by (or on appeal from) a leasehold valuation tribunal or by a Court, or by an Arbitral Tribunal in proceedings pursuant to a post-dispute arbitration agreement, that the amount of the service charge or administration charge is payable by him, or
(b) The tenant has admitted that it is so payable."

Two other significant changes are made under the "new law". First, the Landlord cannot serve a Notice under Section 146 of the 1925 Act until the determination or agreement has been made (New Section 81(4a) 1996 Act). Secondly, the period during which the Landlord cannot forfeit is extended until 14 days after the determination is appealed or the time or the time for appealing has expired (New Section 81(3)).

Seeking a Determination

In a situation where the current tenant has failed to pay the service charge, plainly the Landlord must obtain a determination before seeking to forfeit. Provisions of the 1996 Act however, raise a difficulty in the situation where the Landlord is seeking to recover arrears of service charge which accrued prior to an assignment. Who is the "tenant" against the determination must be sought? It cannot be the assignee as he is not liable to pay the charge. He can only be required to pay the service charge if he is required to do so as a term of relief from forfeiture. On the other hand, although a determination may be obtained against the assignor, that the termination is not to be binding on the assignee. It seems that the way forward is to seek a determination against the assignor. If there are difficulties in locating the assignor, substituted service can be affected. The assignee should be served with a copy of the proceedings together with a covering letter explaining that the Landlord intend to forfeit if the arrears are not paid and should be invited to join the proceedings if he so wishes.

Protecting the Landlord's Position

To summarise the position thus far:-

- (a) as a matter of personal liability, an assignee is not liable for arrears of service charge accrued by his assignor;
- (b) the Landlord can, however, use forfeiture proceeding to recover the service charge arrears as a condition of granting relief from forfeiture; and
- (c) before effecting forfeiture proceedings, the Landlord must obtain a determination that the arrears are due.

The threat of forfeiture (or perceived threat of forfeiture) means that purchasers of flats will in most cases check that service charges have been paid before purchasing. Where inquiries are made of the landlord, the purchaser can be warned of the existence of those arrears. It is then for the purchaser either to ensure that those arrears are paid or to take the risk of purchasing a lease which is liable for forfeiture.

Where no such inquiries are made or the purchaser buys without obtaining such information, the landlord may seek a determination of liability in the matter set out above and subsequently issue forfeiture proceedings.

Waiver

One issue that arises is the extent to which the landlord should be concerned about waiver. It is well known that once a breach of covenant that entitles the landlord the forfeit occurs, the landlord is put on election either to forfeit the lease or to treat the lease as continuing. If, once that election arises he acts a way that is incompatible with the lease being at an end, he is said to have waived his right to forfeit. Where the breach of covenant is a "once and for all" breach, the landlord loses the right to forfeit for that breach.

The question is the extent to which this is affected by Section 81 of the 1996 Act. Prior to Section 81 in a service charge case, it was clear that the landlord was put on election as soon as the time stated in the forfeiture proviso expired. There is an argument, however, that the effect of Section 81 is that the landlord is not put on election until the determination has been made; otherwise, he cannot know whether he has the right to forfeit.

This is a confusing situation.

The Brethertons' view is that if a landlord cannot exercise a right of re-entry until the determination has been made, it is difficult to see how he can be said to be in a position to waive that right until the determination has taken place. Until then, he has no right of election.

Recovery of Balance

In many leases, the tenant pays a service charge at the beginning of the service charge year based on the landlord's estimates service charge for the year. At the end of that year, the actual service charge for the year is calculated and there is a reconciliation of the account with the tenant paying the balance (if any). If an assignment takes place during the course of the year, the assignor did not pay the whole or part of the advanced service charge, can the landlord demand the whole sum from the assignee or can he only demand the balance between the estimated and actual service charge?

It is to be noted that this will *always* depend upon the terms of the lease (another blatant plug for the Brethertons lease review service!)

Many service charge clauses, merely allow the landlord to serve a second demand for the balance only. If that is so, it is difficult to see how a landlord could include arrears from the demand based on estimates.

As a matter of conveyancing practice, this is not unusual for the purchaser of a flat to have a retention from the purchase price to cover this situation.

Assignment with Consent

It is not common for a long lease of a flat to require the landlord's written consent to an assignment of the lease, although some leases do impose such a requirement (often in the context of the last few years of the lease).

Where assignment is expressed to be the subject to the landlord's consent, the landlord cannot unreasonably withhold that consent (Section 19 Landlord and Tenant Act 1927). Indeed a landlord who unreasonably withholds consent may be liable in damages (Section 4 Landlord and Tenant Act 1988).

Normally the issue will be the suitability of the proposed assignee. The question arises, however, as to whether failure on the assignor's part to pay service charges could amount to a reasonable ground for withholding consent.

Woodfall states: "Where the breach committed by the tenant is a once and for all breach, and the landlord reasonably takes the view that he might waive the right to forfeit if he consents to an assignment, it will be reasonable for him to refuse consent."

The authority for the proposition in Woodfall is *Yorkshire Metropolitan Properties –v- Co-operative Retail Service*. If a landlord risks not being able to recover service charges once the assignment takes place, he must be able to refuse consent to the assignment. This, of course, begs the question whether the landlord in the case of a residential lease can be said to be at risk of waiving the forfeit. In this article, we have drawn attention to the possible effect of Section 81 of the Housing Act 1996. If our analysis of that Section were correct, then – unless a determination has already been made - there would be not risk of waiver and so no reason why not to consent to the assignment.

Nevertheless, even if there is no risk of waiver by consenting to the assignment, it seems that there would still be good reasons not to consent to the assignment. The landlord would still be faced with difficulties by recovering the arrears, i.e. the need to seek a determination against the assignor. Our view is therefore that a landlord would be justified in withholding consent where there are service charge arrears.

Conclusion

As this article has identified, there are a number of scenarios which are anything but certain.

What is clear is that an assignee is not liable as a matter of debt for arrears accruing before the assignment. What also appears to be clear - certainly in relation to old leases – is that the landlord may still use the threat of forfeiture as an effective tool to ensure that the assignee will pay the arrears. In most cases, however, the concern will be whether the landlord can be said to have waived the right to forfeit. As with many legal conundrums, these issues remain to be tested in the Courts.

Footnote – the issues raised in this article have been extracted from an Opinion received from Andrew Dymond of Arden Chambers. www.ardenchambers.com

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