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Service Charge Disputes: When a landlord's certificate is both conclusive, and not...

Sara & Hossein Asset Holdings Ltd v Blacks Outdoor Retail Ltd [2023] UKSC 2

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On 18 January 2023, the Supreme Court handed down judgment in Sara & Hossein Asset Holdings Ltd v Blacks Outdoor Retail Ltd [2023] UKSC 2. The key issue was whether a certificate produced by the landlord, provided to be "*conclusive*" as to the service charge sum payable by the tenant (in the absence of manifest or mathematical error or fraud), prevented the tenant from withholding payment on the basis that certain charges were outside the landlord's repairing covenant.

What did the court decide?

A 4-1 majority held that the certificate was conclusive as to the sum payable by the tenant. So, subject to the express defences of manifest or mathematical error or fraud, the tenant would have to pay the sum provided by the certificate (at [51]). There was also a no set-off clause which meant that a tenant could not hold up payment by asserting disputed claims (at [56]).

However, the majority held that the certificate was not conclusive as to the tenant's underlying liability. Despite the no set-off clause, the tenant could later bring a claim seeking repayment of a cost said to be improperly charged (at [57]). In summary, the clauses relating to the certificate created a 'pay now, argue later' provision (at [57]).

The approach to conclusivity is encapsulated by Lord Hamblen JSC's dictum in his majority judgment at [54]: "*This interpretation accords with the language of the lease because although paragraph 3 states that the certificate shall be "conclusive", it does not state how it is to be conclusive. It may be conclusive as to the requirement to make payment on a particular date under Schedule 6, or it may be conclusive as to the underlying liability for the service charge under the lease generally. The document inspection*

provisions […] indicate that it is former […]".

What are the key implications for practitioners?

This case may be a useful precedent for landlords with similar 'pay now, argue later' certification provisions for service charges. The court's interpretation emphasised the landlord's interest in obtaining payment pursuant to the certificate without delay or dispute. The permitted defences were narrow. If there was a dispute as to underlying liability, it would be for the tenant to bear the burden of issuing and establishing a claim after it had already made the payment.

The case is a reminder to those drafting leases, or indeed any contract, that leaving matters open even in a seemingly small way can lead to perhaps unintended consequences. The lease stated the certificate was conclusive but did not expressly state what it was conclusive of.

For litigators, this case is a reminder of the iterative approach to contractual interpretation favoured by the courts, by which each suggested interpretation is checked against the provisions of the particular contract and its implications and consequences are investigated. The court did not find the authorities relied upon as analogies by the parties helpful, given they were about different contracts and contexts. The court also found that the parties' rival interpretations both failed on this approach, as they involved contextual inconsistences and uncommercial consequences, so the court arrived at its own interpretation.

What were the facts?

This was a lease for commercial premises, the tenant being the well-known outdoor clothing chain Blacks. The dispute arose when the tenant paid the main rent and certain other charges for 2017-18 and 2018-19, but not the service charge. Whereas in 2016-17 the landlord charged around £55,000 as service charge, in 2017-19 the landlord charged £400,000.

In April 2019, the landlord issued proceedings for the unpaid service charge. The tenant served a defence alleging that the sums certified were not within the landlord's repair covenant or were unnecessary. The landlord sought summary judgment, and it is that application which ended up being appealed to the Supreme Court.

The material provisions of the lease are explained at paragraphs [13] – [25] of the judgment. In summary:

1. Schedule 6 contained the regime for calculation and payment of the service charge. The tenant was required to make a quarterly payment on account following estimates from the landlord. At the end of each year, the landlord was to calculate the total reasonable and proper cost of providing services and expenses, and the tenant was to pay a fair and reasonable proportion of such cost;

2. The certification provision was that: *"The landlord shall on each occasion furnish to the tenant as soon as practicable after such total cost and the sum payable by the tenant shall have been ascertained a certificate as to the amount of the total cost and the sum payable by the tenant and in the absence of manifest or mathematical error or fraud such certificate shall be conclusive";*

3. If there was any difference between the sums paid on account and the sums payable by virtue of the certificate, the relevant party would have to make a balancing payment for the difference;

4. Schedule 6 also required the landlord to make all relevant receipts and invoices available to the tenant for 12 months after the certificate, and the tenant was entitled to inspect the landlord's books and records etc;

5. The no set-off provision required the tenant to pay the yearly rent reserved by the lease (which included the service charge) at the times and in the manner required "*and not to exercise or seek to exercise any right or claim to withhold rent or any right or claim to legal or equitable set-off or counterclaim (save as required by law)".* It was agreed that this included service charge sums.

What was the court's reasoning?

Lord Hamblen JSC referred to the well-known general principles of contractual interpretation. He then considered the express defences, and the meaning of "*mathematical error*", "*fraud*" and "*manifest error*". Such defences were held to be narrow. For a manifest error, not even an arguable error would be sufficient, however well founded the argument may ultimately prove to be (at [34]).

As to relevant background knowledge, it was emphasised that cashflow is an important consideration for a landlord. A landlord is obliged to incur costs under its repair covenant and is interested in securing repayment promptly (at [36]).

The landlord had argued for a 'pay now, argue never' regime, while the tenant had argued for an 'argue now, pay later' regime. The court found neither party's interpretation satisfactory on an iterative approach (at [49]). The court's interpretation was held to assure the landlord of payment of the service charge without protracted delay or dispute (at [51], [55]). At the same time, the interpretation did not preclude a dispute as to underlying liability for the payment and gave full effect to the tenant's inspection rights (at [51]-[52]).

It was held that the no set-off provision did not extinguish the right to bring a counterclaim. Much clearer language would be required to have that drastic effect (at [56]). But it did prevent the tenant from holding up payment by the assertion of a disputed claim.

It followed from all this that the landlord was entitled to summary judgment on the certificate (a payment would have to be made), but the tenant would not be prevented from pursuing its counterclaim (challenging parts of the payment once made) (at [58]). The no set-off clause meant that any application for a stay of the claim for payment pending resolution of the counterclaim was "*most unlikely to be granted*" (at [56]).

As a final point it is worth noting Lord Briggs JSC's dissenting judgment. He criticised the construction favoured by the majority, being "*unable to find any peg, within the language of the lease, upon which to hang the construction that "shall be conclusive" […] means only conclusive as to the requirement to make a balancing payment […] but leaving ultimate liability up for grabs*" (at [65]).

He considered the certificate to be conclusive as to liability, and in doing so was a lone voice in the Supreme Court favouring the landlord's 'pay now, argue never' approach.

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