

User Guide

Management Companies – A Dangerous Business?

In recent times we have seen a significant increase in the number of rented flats and in many cases the responsibilities for the day-to-day to management of the same have been left to the tenants who often take it upon themselves to be appointed as directors to run the management company.

At first glance this may seem like the easy option. However, there are a number of factors to consider.

Overview

Directors of management companies must abide by their duties as directors under the Companies Act 2006 ('CA 2006') and ensure that they are operating the management company in accordance with the company's articles of association (i.e. the document setting out the basic management and administrative structure of the company which regulates the internal affairs of the company 'the articles'). Directors must also be aware of the correct procedures to be followed when holding meetings.

Management companies ought to have regard to the Landlord and Tenant Act 1985 ('LTA 1985') which contains important provisions regarding monies that can be spent by management companies and the management company's obligations to inform tenants of such spending.

All of the above must also be considered in conjunction with the terms of the leases between the tenants and the management company and cannot be considered in isolation.

Therefore, a role that may initially have been adopted by tenants in the spirit of neighbourliness in reality carries responsibilities that many people are probably not aware of. For example, when carrying out their role as a director of a management company, how many people check the terms of the lease? How many people check

the company's articles? And how many people are actually aware of the existence of the LTA 1985?

Directors' Duties:

CA 2006

Sections 171 to 177 of CA 2006 set out the duties held by directors of a company.

In short, directors have a duty to act within the powers conferred in the company's constitution (i.e. articles and memorandum) and only exercise the powers for the purposes for which they are conferred (Section 171 CA 2006). Further duties include the duty to promote the success of the

company (Section 172 CA 2006), duty to exercise independent judgment (Section 173 CA 2006), duty to exercise reasonable care, skill and diligence (Section 174 CA 2006), duty to avoid conflicts of interest (Section 175 CA 2006), duty not to accept benefits from third parties (Section 176 CA 2006) and duty to declare interest in proposed transaction or arrangement (Section 177 CA 2006).

In simple terms this collection of duties can be seen as a code or charter which underlines how a director ought to conduct themselves.

LTA 1985

One particularly important provision to be aware of under LTA 1985 is the requirement for tenants to partake in a formal Section 20 consultation when a management company (or other residential landlord for that matter) proposes to incur substantial expenditure. A Section 20 notice is a reference to Section 20 LTA 1985 which deals with service charges payable by tenants.

Under Section 18 of LTA 1985 the term “service charge” includes payments other than rent which are payable (whether directly or indirectly) for services, repairs, maintenance or insurance or the landlord’s costs of management and such charges may vary depending upon the costs or estimated costs incurred or to be incurred in connection with items falling under the definition of “service charge”.

However, Section 19 of LTA 1985

contains a caveat in that the “service charge” payable by a tenant can only be recouped by the management company if such costs are reasonably incurred and if the works are of a reasonable standard. This may vary from case to case depending upon the circumstances.

If a tenant is not happy with the level of the “service charge” requested, a tenant may apply to a leasehold valuation tribunal for a determination as to whether or not the costs were reasonably incurred, the works were of a reasonable standard and whether an amount payable before costs are incurred is reasonable.

Section 20 LTA sets down the limitation on tenants’ contributions by reference to regulations of the Secretary of State. Such limitations will not apply where the consultation requirements have been either complied with in relation to the works by agreement or dispensed with in relation to the works agreement by (or on appeal from) a leasehold valuation tribunal.

In order for the “consultation requirements” to be complied with under Section 20ZA(4) it is therefore advisable that the proposed works are explained to tenants (i.e. what the proposed works are and why they are required) and that quotations are obtained for works/services before engaging in the same. Such information should be provided to and discussed with the tenants (as directors of the company) at a meeting of directors. Tenants may suggest that further quotations are obtained and the matters can then

be voted upon. In addition, there is a requirement under Section 21B(1) of LTA for a notice to accompany a demand for a “service charge” which must turn be accompanied by a summary of the rights and obligations of tenants of dwellings in relation to service charges.

Under Section 21 LTA 1985 Management companies should also forward regular statements of account to each tenant by whom service charges are payable. Statements of account in relation to an accounting period must be supplied to each tenant not later than six months after the end of the accounting period. Failure to comply will provide the tenant with the right to withhold the “service charge” (Section 21A LTA 1985). It should be noted that



failure to comply with the provisions of Section 21 LTA 1985 leaves the directors liable upon conviction to a fine.

If all of the above is complied with this ought to avoid any potential problems in respect of the services charges being requested from the tenants. Of course, the management company will need to ensure that adequate notice of

such a meeting is provided to ensure that a vote at a meeting is valid in the event of the absence of a director from a meeting. (Notice of meetings is dealt with elsewhere in this article).

It is much better if matters can be dealt with internally without the need to involve a leasehold valuation tribunal. This will also be beneficial if not essential to the ongoing relationship between the directors and tenants of the management company and to avoiding liability of the directors.

Lease

As already stated the directors' duties as set out under the CA 2006 and LTA 1985 must be exercised in the light of the directors' obligations under the lease.

Each lease will vary and therefore directors would be advised to consider each individual lease carefully when exercising their duties.

Notice for Annual General Meetings and Emergency General Meetings:

As explained above it is not enough to merely hold a meeting of the tenants and directors of the management company; in order for any decisions reached at such a meeting to be valid, the meeting itself must have been convened in accordance with legal requirements.

In accordance with Section 307(1) CA 2006 any general meeting of a private company (unless an

adjourned meeting) must be called giving at least 14 days notice. Such meetings may be called on shorter notice if agreed by the members (subject to certain requirements as set down by Section 307(5) & (6) CA 2006).

However, regard must also be had to the company's articles as the articles may provide for a longer period of notice to be given. Where the articles do provide for a longer period of notice to be given, the articles will prevail.

Directors' Insurance:

In the light of the above it is highly advisable that companies take out insurance policies in respect of directors' liabilities. This is permitted under Section 233 CA 2006.

This should also be supported by the insertion of an indemnity clause in the company's articles.

For further advice on the issues contained within this article or any other company/commercial matter, please contact a member of the company commercial team on 0161 785 3500. Roger Hinchliffe, Partner of the company commercial team may be contacted on 0161 785 3501
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