Room for reform

Natasha Rees reviews the most important enfranchisement cases of 2018

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The government has been busy pursuing a programme of leasehold reform in order to re-address the perceived imbalance of power between parties to long leases. The programme, which continued with an evidence session featuring the Law Commission on 14 January this year, includes reform of the law of leasehold enfranchisement. The aim is to provide greater fairness and transparency for leaseholders. Having considered the leading enfranchisement cases of 2018 it is clear that reform is required. The cases illustrate quite how difficult and complex the process has become, with a number of Upper Tribunal and High Court trials and no less than three Court of Appeal decisions.

Development value

The first case of the year was *Francia Properties Ltd v St James House Freehold Ltd* [2018]. The case involved a collective claim for the freehold of a block of 14 flats under the Leasehold Reform Housing and Urban Development Act 1993. A dispute arose as to the premium payable for the freehold and specifically the amount of development value that should be included. The development opportunity was an additional floor or floors on the roof of the building.

The landlord had obtained advice from a planning inspector that a three-storey addition to the roof would be refused but a single-storey addition could be acceptable in principle subject to certain conditions. Despite this, in May 2015 the landlord applied but was refused permission for three extra storeys (six flats). On 20 October 2015 the tenant served their section 13 notice to acquire the freehold. Following this, three further planning applications were made by the landlord, but all were refused. The First-tier Tribunal (FTT) had determined that the premium should include development value of £295,000 after a 65% discount for planning risk given the history of refusals.

The tenants appealed to the Upper Tribunal (UT) who decided that the FTT had been wrong to have regard to events which took place after the valuation date, namely the date of the section 13 notice. Planning decisions are irrelevant because the hypothetical purchaser at the valuation date would not have been aware of them. Instead, it would have made its own assessment as to the risk of planning permission not being granted. As a result of the decision the UT reduced the development value to £100,000. The decision is useful confirmation that when determining the premium the tribunal must not take account of matters that arise after the valuation date.

Leasehold Reform Act 1967 and consents

The next case, which was decided in March 2018, was a decision of the Court of Appeal on a case known as *Rotrust Nominees Ltd v Hautford Ltd* [2018], which involved a building in Soho let on a 100-year lease. The lease required consent for any planning application for

a change of use. This decision concerned the Leasehold Reform Act 1967 and a request to change the planning use of the property from office use (or use ancillary to retail use on the ground floor) to residential use. The landlord refused consent. It did so because such change of use would increase the prospect of successful enfranchisement under the 1967 Act and in addition, such enfranchisement would damage the landlord's management of the Soho estate. The issue that the Court of Appeal had to decide was whether the refusal was unreasonable.

The landlord argued that the requirement to obtain consent to the making of a planning application for change of use was to protect the landlord from damage to its reversion. The landlord's decision to refuse consent was, therefore, reasonable because it was protecting its property interests. The Court of Appeal disagreed with this rationale. It decided that the residential user provision in the lease was not subject to the planning consent provision. To imply this would effectively rewrite the user clause and give the landlord a collateral advantage. It distinguished the well-known Court of Appeal decisions known as *Norfolk Capital Group Ltd v Kitway Ltd* and *Bickel v Duke of Westminster*, both of which were decided in 1976, on the grounds that the leases in those cases had been granted before the 1967 Act was enacted or foreseen. It also decided that the estate management considerations were met adequately by the provisions of the 1967 Act, which allow restrictive covenants to be included in the transfer of the freehold. The case confirms that there is no general proposition that a landlord can refuse consent to assign, alter or change the use of premises on the grounds that it might lead to enfranchisement and loss of the landlord's interest.

Precarious rights

The next judgment, also given in March by the Court of Appeal, was the decision in *The Corporation of Trinity House of Deptford Strond v 4-6 Trinity Church Square Freehold Limited* [2018]. It is often the case in collective claims that issues arise over communal areas. This appeal highlights a problem concerning precarious or revocable rights over communal gardens.

The tenants of flats in three converted townhouses made a claim for the freehold under the 1993 Act. Each of the tenants had a revocable licence in their lease to use a communal garden. The landlord argued that the rights granted on enfranchisement should also be revocable.

The statutory provisions that govern what property can be acquired are found in s1 of the 1993 Act. Section 1(3) allows tenants to acquire property that is not included in the 'relevant premises' where one of two conditions apply. First, it is appurtenant property demised under the leases or secondly, it is property that the tenant has a right under the lease to use in common with other tenants. In the latter case, the landlord can offer rights in lieu of the freehold. When offering rights the landlord has to offer rights that satisfy the test in s1(4)(a) known as the 'equivalence test'.

There are a number of cases that have clarified how the tests in s1(3) and 1(4) are to be applied. In *Fluss v Queensbridge Terrace Residents Ltd* [2011] the UT held it is necessary to consider what rights the tenants have at the relevant date. The decision was very much based on the actual wording of s1(4)(a). In *Cutter v Pry Ltd* [2014] the UT held that if tenants are going to claim the freehold of land they enjoy rights over, the right must be used in common with other tenants at the relevant date.

Applying the decisions above, precarious rights will qualify under s1(3)(b) because it is necessary to consider the right that is enjoyed at the date of the claim as opposed to what could happen in the future. What is less clear is how the equivalence test under s1(4) is applied to precarious rights. If a landlord offers equivalent rights to the tenants do these have to be the same rights that they enjoy under their leases ie revocable, or is it necessary to look at the right they enjoyed on the relevant date and offer something more permanent? This question came before the Court of Appeal.

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The Court of Appeal felt that the language of s1(4) of the 1993 Act required the rights granted to be permanent, based on the actual wording of the provision. The provision grants 'such *permanent* rights as will ensure that thereafter' the occupier of the flat has 'as nearly as may be the same rights as those enjoyed' under their lease (emphasis added). It also accepted that the Upper Tribunal could rely on support for its decision from s62 of the Law of Property Act 1925, which allows for the conversion of precarious rights to permanent rights.

Although it is rare for tenants to have a revocable licence to use a facility like a garden in their lease, landlords should be aware that where tenants make a collective claim they may be able to take advantage of this decision. If tenants have a revocable licence

to use a garden or other communal property they will be able to seek to acquire the freehold of that property and will be entitled, at the very least, to a permanent right over that property, provided that the licence has not been revoked before the section 13 notice is served.

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The 'no-Act' assumption

The next case heard in June by the Court of Appeal was the case of *Whitehall Court London Ltd v The Crown Estate Commissioners* [2018]. The Court of Appeal had to consider among other things a discrete point regarding the no-Act assumption that is applied when calculating the premium on lease extension claims. The issue was whether the no-Act assumption extends to the block containing the flat or just the flat alone.

In order to determine the premium in a lease extension claim, it is necessary to value the landlord's interest in the tenant's flat both before and after the new lease is granted. This is done by reference to a transaction in the open market but is based on two assumptions. The first is that there is a sale by a willing seller with 'neither the tenant nor any owner of an intermediate leasehold interest buying or seeking to buy'. Without this assumption the existence of special purchasers in the market would increase the valuation. The second assumption is that Chapter I and II of the 1993 Act confer no right to acquire any interest in any premises containing the tenant's flat or to acquire any new lease. This is called the 'no-Act' assumption. It ensures that the open market valuation is not affected by the rights conferred by the Act.

While the Court of Appeal acknowledged that the wording was unclear and could be interpreted either way, it decided that the 'no-Act' assumption did extend to all of the flats in the building. As a result, the premium remained at a higher level because the rights of other qualifying tenants did not depress the value of the landlord's interest.

Section 42 notices and executors

At the end of June a decision was given by the Chancery Appeals Division of the High Court of Justice in the case of *Villarosa v Ryan* [2018]. This case involved two issues under the 1993 Act. The first issue concerned the meaning and effect of s42(4A). The Commonhold and Leasehold Reform Act 2002 introduced this provision into the 1993 Act to allow a personal representative of a deceased to make a lease extension claim if the deceased had accrued the necessary two years' qualifying ownership. Prior to this, those inheriting a lease had to wait two years before making a lease extension claim. The second issue related to s43 of the 1993 Act and concerned the assignment of the benefit of the claim.

The original tenant had died on 4 December 2007 and the executors named in his will obtained grant of probate on 27 April 2010. On 26 April 2016, a transfer of the leasehold title to Mr Vambeck's flat was executed in favour of Ms Villarosa. The transfer was not registered. The executors then served the freeholder with a section 42 notice. The benefit of the notice was assigned to Ms Villarosa in early June 2016 and on 27 June 2016 she became the registered proprietor of the lease of the flat. The landlord served a counter-notice which did not admit the claim on two grounds; namely that the claim had been made more than two years after the grant of probate and the lease had been assigned without the benefit of the section 42 notice.

On the first issue the landlord argued that the effect of s42(4A) of the 1993 Act was to limit the right of a personal representative to make their claim within two years of the grant of probate. Morgan J did not accept this argument. He agreed with the leaseholder that the personal representatives only had to rely on the provision for two years and after this, they would have acquired the necessary two years' ownership and could serve a notice in their own right. He took advantage of the rule in *Pepper v Hart* [1992] to rely on Parliamentary debate which clearly supported this meaning.

On the second issue, the High Court confirmed that the notice had been properly assigned, restating the point that the legal title will only be transferred on registration and thus the executors were capable of assigning the benefit of the claim up to the date of registration on 27 June 2016 when they ceased to hold the legal title.

This decision has clarified that s42(4A) of the 1993 Act does not operate to limit the time by which personal representatives must serve a claim notice. It also confirms that an assignor of a lease can assign the benefit of a claim notice between transfer and registration of title at the Land Registry.

What is a flat?

One of the last reported cases of the year was the case of *Aldford House Freehold Ltd v Grosvenor (Mayfair) Estate* [2018]. The dispute concerned a collective enfranchisement claim relating

to a large block of flats on Park Lane and is a prime example of the novel arguments that landlords will raise to prevent enfranchisement.

The claimant was a nominee purchaser company set up by a number of tenants in the building. They instructed solicitors to serve a section 13 notice seeking to acquire the freehold. The first defendant, Grosvenor, and the second defendant, a head lessee company called K Group Ltd, disputed the claim. The issues raised included:

- whether some of the offshore tenants had properly authorised their solicitor to sign the section 13 notice;
- whether three of the leaseholders were disqualified because they held their flats under two leases with two different landlords (a situation created by the landlord); and
- whether premises on the sixth and seventh floors were 'flats' and if they were, whether a sufficient number of qualifying tenants had been included in the section 13 notice.

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Fancourt J reached a decision on nearly all of the issues and it is useful reading for any practitioners preparing a section 13 notice of claim.

One of the key issues in the case was the definition of 'flats' within the meaning of s101 of the 1993 Act. Under s13(1) of the 1993 Act a notice must be given by not less than one-half of the qualifying tenants in the building on the relevant date, which is the date that the notice is served. It was not in dispute that there were 26 flats in the building, excluding the sixth and seventh floors. The question was whether the six and seventh floors contained any 'flats' given that each floor was essentially a shell. In order to protect its position the nominee purchaser's original solicitors had served two notices. The first notice was given on the basis that there were 26 flats in the building. The second notice was given on the basis that there were 30 flats.

The issue turned on the state of the sixth and seventh floors and whether these areas constituted 'flats' within the meaning of the 1993 Act. The leases of these two floors had been acquired by a company related to the head lessor and the necessary permissions had been obtained for their alteration and extension. Construction work commenced in 2008 and completed in 2013 leaving the new premises as a structural shell. During this time the existing underleases were surrendered and four new leases were granted, two on each floor. At the relevant date the structural works had been completed with raised floorboards and suspended ceilings but there were no internal walls, pipes, cables or other fit-out items in place. The units were therefore uninhabitable but had been demised under separate long leases to be used for residential purposes.

'Flat' is defined by s101(1) of the Act as meaning a separate set of premises (whether or not on the same floor) which forms part of a building and which is constructed or adapted for use for the purposes of a dwelling. 'Dwelling' is defined as meaning any part of a building occupied or intended to be occupied as a separate dwelling. The questions for the judge were whether each of the four flats was a separate set of premises and, if so, whether each was constructed or adapted for use for the purposes of a dwelling.

The judge stated that the statutory definition of 'flat' under the 1993 Act was like the definition of a 'house' under the 1967 Act in that it was concerned with the purpose for which the premises had been constructed or subsequently adapted. The relevant question was whether it has been constructed or adapted for use for the purposes of a dwelling or some other purpose. If the latter, it will not be a 'flat'. The test does not depend on whether the premises can actually be used for living, sleeping or eating on the relevant date. In deciding, he referred to the decision in *Boss Holdings Ltd v Grosvenor West End Properties* [2008].

He therefore determined that at the relevant date the building contained 30 flats. Since the former solicitors had failed to include reference to their second '30 flats' notice in their court application, the judge decided that the said notice had been deemed withdrawn. As a result, the tenants' claim failed. The judge did grant the nominee purchaser permission to appeal on the 'flats' issue so it is an issue that the Court of Appeal will have to grapple with next year.

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Leasehold reform

This final case does emphasise the need for a new regime. The Law Commission's proposed introduction of a single simplified procedure and prescribed forms for all claims may help reduce the number of issues that come to court. Likewise, the proposal to extend the existing powers of the tribunal to allow it to deal with all disputes and issues in respect of enfranchisement should reduce costs.

There is concern, however, that a new system may run into the same problems. It might appear simpler to change the definition of 'houses' and 'flats' to a single 'residential unit' but there was nothing more hotly contested than the definition of a house. To some extent, that caselaw has resolved the issue and there is a better understanding in the market.

Changing the definition will almost certainly lead to a resurgence of such disputes, at least initially. There is also concern about the ability of the tribunals to deal with complex issues encountered in enfranchisement claims such as those raised in this selection of cases.

What is clear, however, is that there is a need for change and, notwithstanding the distraction of Brexit, which threatens to slow down the pace at which reform might be achieved, it is hoped that the changes will in due course result in clearer, simpler enfranchisement processes for leaseholders, freeholders and practitioners alike. ■

Aldford House Freehold Ltd v Grosvenor (Mayfair) Estate & anor
[2018] EWHC 3430 (Ch)

Bickel v Duke of Westminster
[1976] 3 All ER 801

Boss Holdings Ltd v Grosvenor West End Properties & ors
[2008] UKHL 5

Cutter & ors v Pry Ltd
[2014] UKUT 215 (LC)

Fluss v Queensbridge Terrace Residents Ltd
[2011] UKUT 285 (LC)

Francia Properties Ltd v St James House Freehold Ltd
[2018] UKUT 79 (LC)

Norfolk Capital Group Ltd v Kitway Ltd
[1976] 3 All ER 787

Pepper v Hart
[1992] UKHL 3

Rotrust Nominees Ltd v Hautford Ltd
[2018] EWCA Civ 765

The Corporation of Trinity Houseof Deptford Strond v 4-6 Trinity Church Square Freehold Ltd
[2018] EWCA Civ 764

Villarosa v Ryan
[2018] EWHC 1914 (Ch)

Whitehall Court London Ltd v The Crown Estate Commissioners
[2018] EWCA Civ 1704