

# **PART I OF THE LANDLORD AND TENANT ACT 1987 TWENTY YEARS ON – BUT STILL NOT WORKING**

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**by**

**John Furber QC  
Wilberforce Chambers**

*John specialises in all aspects of the law of real property, with an emphasis on property developments and commercial leases. He also has many years of experience in the law and practice of town and country planning and compulsory acquisition of land. Since 1982, he has been editor of Hill and Reman's Law of Landlord and Tenant and is now general editor of that work.*

*He is recommended in the Legal 500 and Chambers UK as a leading silk in the field of property litigation.*

*'Head and shoulders above most for landlord and tenant work', 'a barrister with a soothing manner in court whose relaxing style wins him many backers'. Chambers UK*

*Recommended for his 'practical approach and academic nous' and 'advisory work and development cases'. Legal 500*

**[jfurber@wilberforce.co.uk](mailto:jfurber@wilberforce.co.uk)**

## **Introduction**

- (1) Part I of the 1987 Act, giving rights of pre-emption (rights of first refusal) to “qualifying tenants”, was passed on 15 May 1987, shortly before the General Election in June of that year, at a time when the mismanagement of blocks of flats (considered to be linked to frequent changes of landlord) was a matter of some public concern. Against this background, the draftsman of this Part of the Act might offer a defence of political pressure and expediency against any detailed criticism of his work. However, unfavourable judicial comments were made more than once, the remarks of Sir Nicolas Browne-Wilkinson VC in *Denetower Ltd v Troop* [1991] 3 All ER 661 (“ill-drafted, complicated and confused”) providing only one example.

- (2) These comments were not ignored. Part I was substantially amended by the Housing Act 1996, remedying numerous deficiencies. These amendments took effect as from 1 October 1996 (and it should be noted that many of the reported cases are concerned with the unamended version of the Act). However, despite this, difficulties and doubts still remain and some of these will be considered below, together with some recent case law.
- (3) At the end of this paper, I will consider whether these statutory provisions are still necessary in order to achieve their original purpose, having regard to other legislation now in being, intended to enhance the rights of residential leaseholders, and whether their impact upon commercial property transactions is justified.

### **The scope of Part I of the Act**

- (4) The key provision is section 1(1):

“A landlord shall not make a relevant disposal affecting any premises to which at the time of the disposal this Part applies unless –

- (a) he has in accordance with section 5 previously served a notice under that section with respect to the disposal on the qualifying tenants of the flats contained in those premises (being a notice by virtue of which rights of first refusal are conferred on those tenants) and
- (b) the disposal is made in accordance with the requirements of section 6 to 10.”

- (5) The key expressions which have to be defined in order for section 1(1) to be understood are (i) “landlord” (ii) “premises” (iii) “qualifying tenants” and (iv) “relevant disposal”. These definitions will now be considered briefly in turn, although they must be read together in every case. It will be seen that, while “qualifying tenants” are only tenants of flats, “premises” may include buildings containing a very substantial element of commercial space.

## **Landlord**

- (6) By section 2(1) the “landlord” is usually only the immediate landlord of the qualifying tenants (but see section 2(2) for cases where a landlord has only a short term interest). Thus, if a freeholder of mixed business/residential premises lets the business premises as a whole to (say) an associated company, then that company is not subject to Part I of the Act and can deal freely with the business premises on their own.

## **Premises**

- (7) (i) The primary definition is in section 1(2):

“Subject to subsections (3) and (4), this Part applies to premises if –

- (a) they consist of the whole or part of a building; and
  - (b) they contain two or more flats held by qualifying tenants; and
  - (c) the number of flats held by such tenants exceeds 50 per cent of the total number of flats contained in the premises.”
- (ii) Surprisingly, there is no definition of the crucial word “building”; all the more surprising because elsewhere in the 1987 Act, in provisions relating to acquisition orders, the draftsman shows that he knows how to provide a definition in familiar terms so as to include “any yard, garden, outhouse or appurtenance belonging to, or usually enjoyed with, the premises” (section 29(4)).
- (iii) It is thus not clear whether, to take the most obvious examples, gardens and garages are parts of a building, such as a block of flats. The court therefore has to provide a solution and in *Denetower Ltd v Troop* [1991] 3 All ER 661 it was decided that “building” for these purposes was not confined to the bricks and mortar of which the actual building was constructed but extended to other areas expressly or impliedly included in the demises of the flats to the qualifying tenants (in that case, the gardens, but not the garages, which were held under separate leases).

- (iv) What is the position where a landlord proposes to dispose of several buildings, for example all within one residential estate? Section 5(3) appears to provide the answer:

“Where a landlord proposes to effect a transaction involving the disposal of an estate or interest in more than one building ... he shall, for the purpose of complying with this section, sever the transaction so as to deal with each building separately.”

It does not however tell us how the severance (necessarily involving the apportionment of the purchase price) must be done – presumably the landlord must act reasonably in making the apportionment.

- (v) But it is not that simple. There has been further judicial glossing and it was held in *Long Acre Securities v Karet* [2005] Ch 61 that there are some circumstances in which property comprising more than one structure can be one “building” for these purposes – for example, in the case of an integrated development where a number of structures share the use of appurtenant premises. In such a case, it was held that there is no requirement to sever a proposed transaction in accordance with section 5(3).
- (vi) The primary definition refers to exceptions in sections 2(3) and 2(4). The latter relates to exempt landlords and resident landlords. The former deals with business premises:

“This Part does not apply to premises falling within subsection (2) if –

- (a) any part or parts of the premises is or are occupied or intended to be occupied otherwise than for residential purposes; and
- (b) the internal floor area of that part or those parts (taken together) exceeds 50 per cent of the internal floor area of the premises (taken as a whole);

and for the purposes of this subsection the internal floor area of any common parts shall be disregarded.”

- (vii) In a typical case of mixed business/residential premises subject to the Act, the flats will have been sold on long leases at a nominal rent and the business premises (shops) will be let at reviewable market rents. The value of the landlord's interest is predominantly derived from the reversion to the shops, but the residential lessees will have the opportunity to acquire it (and they may be backed by a commercial property investor).

### **Qualifying tenants**

- (8) A person is a qualifying tenant of a flat if he is tenant under a tenancy other than those specified in section 3(1), subject to the other exceptions in section 3. Most frequently, qualifying tenants will be long lessees as described in paragraph 7(vii) above. Assured tenants are excluded; curiously, statutory tenants under the Rent Act are not excluded. As will be seen, qualifying tenants may take advantage of their rights if there is a "requisite majority" (more than 50 per cent) in favour.

### **Relevant disposal**

- (9)
  - (i) These are defined widely in section 4 as including a surrender of a tenancy and the grant of an option or right of pre-emption (see section 4(3)), but excluding the disposals described in section 4(2). Contracts to create or transfer an estate or interest in land are included (section 4A).
  - (ii) The primary definition is in section 4(1):

"In this Part references to a relevant disposal affecting any premises to which this Part are references to the disposal by the landlord of any estate or interest (whether legal or equitable) in any such premises, including the disposal of any such estate or interest in any common parts of any such premises but excluding –

- (a) the grant of any tenancy under which the demised premises consist of a single flat (whether with or without any appurtenant premises) and
  - (b) any of the dispositions falling within subsection (2).”
- (iii) How does this definition apply in relation to premises or parts of premises which include business premises, within the meaning of section 1? If the landlord is the immediate landlord of both the residential and business tenants, then plainly Part I of the Act applies (as to the commercial consequences, see paragraph 7(vii) above). Other cases may create more difficulty. Consider a case in which the freeholder has let the business parts of the premises to an associated company, as contemplated in paragraph 6 above, and the freeholder and the associated company then dispose of their two interests together. Here there is a relevant disposal by the freeholder of his interest, so that Part I must apply, and thus it seems that the purchase price for the two interests being sold together must be apportioned. This analysis might be considered as requiring yet another gloss upon the words used in the statute.
- (iv) The language of section 4(1) gives rise to a more fundamental difficulty where the landlord is the immediate landlord of both the residential and business parts of the premises. It is expressly provided that the grant of a tenancy of a single flat is not a ‘relevant disposal’, but there is no such provision relating to the grant of a tenancy of, for example, a single shop unit. On the face of it, this would be a disposal of an interest in the premises subject to the Act. However, it cannot have been the intention of Parliament that the qualifying tenants should be given the right of first refusal of a shop – see the long title of the Act in which the purpose of Part I is described as being “to confer on tenants of flats rights with respect to the acquisition by them of their landlord’s reversion” (and for a case where the long title was used as an aid to construction, see *Kay Green v Twinsectra Ltd* [1996] 4 All ER 546).

- (v) Section 4(2) sets out numerous classes of disposition which are not “relevant disposals”. Dispositions to associated companies are only excluded if the companies have been associated for at least two years, but there is no disposition if there is a sale of all the shares in a landlord company.

### **The required procedures**

- (10) In short, sections 5 – 5E contain requirements for service of an “offer notice” by the landlord proposing to make a relevant disposal on the qualifying tenants, varying somewhat depending upon the nature of the proposed disposal. Such a notice must specify a period within which the offer may be accepted (being not less than two months beginning with the date of the service of the notice). During that period, the landlord shall not dispose of the interest which is the subject of the offer notice except to a person nominated by the tenants under section 6 (section 6(1)) and the “requisite majority of the qualifying tenants” (more than 50% – see section 18A) may serve an “acceptance notice”. The offer notice must also specify a further period of not less than two months within which a “nominated person” (usually a new company) may be nominated by the requisite majority and, where an acceptance notice is served, the landlord shall not dispose of the “protected interest during this period. If no acceptance notice is served or no person is nominated within the time limits described above, the landlord is then free (to the extent specified in section 7) to dispose of the “protected interest” on the terms proposed – but it will be seen that there may be a delay of more than four months between the landlord agreeing a proposed transaction with a third party and knowing whether he is able to complete it (and for further uncertainties, see below).
- (11) It might be thought that the service of an acceptance notice followed by the nomination of the “nominated person” would create a contract between the landlord and the nominated person. However, this is not so; by section 8(3) the landlord is given the choice, to be exercised within one month of the notice of nomination, either (a) to serve notice on the nominated person indicating an intention no longer to proceed with the disposal of the “protected interest” or (b)

to become obliged to proceed in accordance with the following provisions of the Act (requiring, in most cases, the landlord sending a form of contract to the nominated person within the period of one month beginning with the date of service of the notice of the notice of nomination – see section 8A(2)). Thereafter, the nominated person has a period of a further two months either to serve notice on the landlord indicating an intention no longer to proceed with the acquisition of the protected interest or offer an exchange of contracts (section 8A(3)). Thus, there is potentially another three months of uncertainty following the date identified in paragraph 10 above, when the landlord might think that the nominated person would be likely to proceed. Where notice of withdrawal by the nominated person is given, the landlord is free to dispose of the protected interest on the proposed terms (section 9A). If the landlord gives notice of withdrawal, he is not entitled to dispose of the protected interest for 12 months (section 9B) and then of course must go through the whole procedure again.

- (12) The cumbersome and therefore, it is suggested, unsatisfactory nature of these provisions is apparent from this attempt at a brief description.

### **Sanctions and enforcement**

- (13) The making of a relevant disposal by a landlord in contravention of the provisions described above confers various legal rights upon the requisite majority of the qualifying tenants (see below). However, the revisions introduced in 1996 also provide (in section 10A) that he thereby commits a criminal offence (in the absence of “reasonable excuse”). The validity of the disposal as not in itself affected – it is up to the requisite majority of the qualifying tenants to take action when they discover they have a new landlord.
- (14) (i) The first right given to the requisite majority is the right to serve on the purchaser a notice requiring information as to the terms of the disposal (section 11A(1)). By section 54(2), which is of general application, any notice purporting to be served by the requisite majority “shall specify the names of all of the persons by whom it is served and the

addresses of the flats of which they are qualifying tenants.” The use of the word “shall” in provisions of this sort often causes difficulties: in *Tudor v M25 Group Limited* [2004] 2 All ER 80 a case concerned with a section 11A notice, it was held that the requirement to specify the addresses of the tenants was directory rather mandatory, so that a failure did not invalidate the notice. The requirement to state the names of the persons giving the notice is, however, mandatory.

- (ii) Section 11A(3) imposes, to a narrow extent, a time limit upon the ability to exercise the right;

“Any notice under this section must be served before the end of the period of four months beginning with the date by which

- (a) notices under section 3A of the Landlord and Tenant Act 1985 (duty of new landlord to inform tenant of rights) relating to the original disposal, or
- (b) where that section does not apply, documents of any other description –
  - (i) indicating that the original disposal has taken place, and
  - (ii) alerting the tenants to the existence of their rights under this Part and the time within which any such rights must be exercised.

have been served on the requisite majority of qualifying tenant of the constituent flats.”

It will be seen that this time limit only applies if the requisite majority have been alerted to the existence of their rights by documents served upon them. Otherwise, there is no time limit imposed upon the right to serve a section 11A notice, even where the qualifying tenants have been informed of the relevant disposal itself.

- (iii) By section 11A(4) a person served with a notice under the section shall comply with it within the period of one month beginning with the date on which it is served on him. Once the requisite majority have been given details of the disposal (most importantly, the price paid), then the primary remedies considered below may be pursued.

- (15) (i) Sections 12A – 12D contain provisions which, in effect, enable the requisite majority to take the benefit of the relevant disposal after it has been effected (and note that all these rights, including the rights in section 11A are also available against a subsequent purchaser – see section 16)
- (ii) Section 12B, dealing with a completed sale by the landlord, provides a good example. The requisite majority may serve a “purchase notice” on the purchaser requiring him to dispose of the estate or interest which was the subject matter of the original disposal to a person nominated by the requisite majority, on the terms on which the original disposal was made.
- (iii) Again, there is a time limit of a restricted nature in section 12B(3). If a notice has been served under section 11A, the section 12B notice must be served before the end of the period of six months beginning with the date on which the purchaser complied with the notice. In other cases there is a six-month time limit from the date when the requisite majority had been served with documents of the same sort as those described in section 11A(3), but no time limit in cases where no such documents have been served. Thus it appears that the requisite majority can exercise the right given by this section many years after the relevant disposal, notwithstanding full knowledge of that disposal.
- (iv) When a section 12B notice is served years after the relevant disposal has taken place (as is entirely possible) then section 12B(7) will need to be considered:

“Where the property which the purchaser is required to dispose of in pursuance of the purchase notice has since the original disposal increased in monetary value owing to any change in circumstances (other than a change in the value of money) the amount of the consideration payable to the purchaser for the disposal by him of the property in pursuance of the purchase notice shall be the amount that might reasonably have been obtained on a corresponding disposal made on the open market at the time of the original disposal if the change in circumstances had already taken place.”

The provision will be applicable where the purchaser has improved the value of the property by, for example, obtaining vacant possession of a flat or building a new flat. The increase in value to which he is entitled is, however, assessed as at the date of the original disposal, not at the date of the section 12B notice.

- (16) (i) The service of a purchase notice does not in itself create a contract and, prior to entering into a binding contract, the nominated person may serve notice indicating an intention no longer to proceed (section 14). There is no provision specifying the date when the nominated person and the purchaser must enter into a contract. However, by section 17(3)

“Where a period of three months beginning with the date of service of a notice under section 12A, 12B, or 12C on the purchase has expired –

- (a) without any binding contract having been entered into between the purchaser and the nominated person, and
- (b) without there having been made any application in connection with the notice to the court or to a leasehold valuation tribunal,

the purchaser may serve on the nominated person a notice stating that the notice, and anything done in pursuance of it, is to be treated as not having been served as done.”

- (ii) By section 13, a leasehold valuation tribunal has jurisdiction to determine any question arising in relation to any matters specified in a notice under sections 12A – 12C (essentially matters of detail). Questions of principle, such as the validity of such a notice, must be determined by the court (see *Denetower Ltd v Troop* [1991] 3 All ER 661). By section 19(1) the court has power to “make an order requiring any person who has made default in complying with any duty imposed on him by any provision of this part to make good the default within such time as is specified in the order.” It seems that this jurisdiction (which, by virtue of section 19(3), can be exercised by grant of an injunction) is of a discretionary nature (see *Michaels v Harley House (Marylebone) Ltd* [2000] Ch 104) but the circumstances in which the court may refuse to enforce a duty under the Act have not yet been fully explored.

## Leasehold transactions

- (17) (i) A 'relevant disposal' by the landlord may take a number of forms, including the grant of an over-riding lease. If the landlord is himself a leaseholder, a surrender of his lease to the freeholder is a relevant disposal and if the landlord does not first comply with the provisions of the Act, the requisite majority can serve a notice on the freeholder requiring him to grant of a new lease on the same terms as the surrendered lease (section 12C).
- (ii) In this context, the recent decision of the Court of Appeal in *Kensington Heights Commercial Co Ltd v Campden Hill Developments Ltd* [2007] 2 All ER 871 provides a good example of the complex workings of these statutory provisions. In that case, the landlord entered into an agreement with the freeholder for the surrender of the headlease to be followed by the grant of a new lease back to the landlord of the premises demised by the headlease, less a boundary strip of land. This agreement was then implemented, but no notices were served on the qualifying tenants.
- (iii) Several years after this happened, the requisite majority sought to enforce the statutory rights; relying on section 12B and section 16, it was contended that the landlord should transfer the new headlease to the nominated person. This apparently reasonable construction of the Act was found by the Court of Appeal to be wrong. The right given by the Act in this case was to serve a section 12C notice on the freeholder, and thereby become entitled to the grant by the freeholder of a lease on the same terms as the surrendered lease. The new headlease would not, it seems, be affected and the landlord would in any event remain the landlord of the qualifying tenants throughout. Lawrence Collins LJ said that "commercially" the landlord was not disposing of its interest and thus the conclusion was consistent with the scheme and purpose of the Act described as follows:

"... to give effect to a policy restricting the right of the landlord to dispose of his interest in the reversion without reference to the wishes of the tenants, and leaving tenants uncertain as to the

identity of their landlord and therefore unable to take any effective action; and to give the tenants in a block where the majority wanted it a power to manage the block themselves and so have a greater say in their own affairs.” (p. 766/767)

### **A precautionary measure**

- (18) (i) It is obvious from all the above that these provisions are unattractive to a prospective purchaser pursuant to a relevant disposal, because of the inherent uncertainty as to his position.
- (ii) By virtue of section 18, a prospective purchaser may serve notice indicating the principal terms of the proposed disposal on all the tenants of the flats contained in the premises (NB not just the qualifying tenants) in essence inviting each tenant to serve a notice stating whether he has been or is not entitled to be served with a section 5 notice and whether, if such a notice were served, he would wish to avail himself of the right of first refusal. Where the purchaser has served such notice on at least 80 per cent of the tenants and either (i) at the end of a period of two months not more than 50 per cent of them have served notices in response or (ii) more than 50 per cent of them have served notices in response stating they are not entitled to the right of first refusal or would not wish to exercise it, then the premises affected by the disposal shall be treated as premises to which these provisions do not apply.
- (iii) These provisions may be used when a section 5 notice has been served or is about to be served – and they do not relieve the landlord from his duty to serve a notice under section 5 as soon as he proposes to make a relevant disposal (see *Mainwaring v Trustees of Henry Smith’s Charity* [1998] QB 1). It is therefore doubtful whether they are of much general utility, though they may be of assistance in cases where it seems unlikely or is doubtful that there is a sufficient number of qualifying tenants to enable rights under the Act to be exercised.

### **Is all this necessary?**

- (19) (i) Statutory provisions which require a landlord to give a right of first refusal in relation to a proposed transaction are not essentially unfair or unreasonable, because the landlord has decided to make the disposal and the consideration has been fixed. In principle, this might seem preferable to compulsory acquisition at a price to be determined. However, the provisions considered above are most politely described as unwieldy, even after amendment in the light of experience and criticism.
- (ii) Since 1987, numerous other statutory provisions for the benefit of residential leaseholders have come into effect. The Commonhold and Leasehold Reform Act 2002 gives a new right to leaseholders of flats to take over the management of the building in which their flat is situated, without having to prove shortcomings on the part of their landlord and without having to pay compensation to him. This is in addition to the right of collective enfranchisement given to such leaseholders by the Leasehold Reform, Housing and Urban Development Act 1993, and extended by the 2002 Act. However, it should be noted that these rights can only be exercised in relation to premises where the commercial element is 25%.
- (iii) It is far from clear why any right of pre-emption is now necessary, having regard to the existence of these other rights. It is only of real practical utility in cases where the commercial element is between 25% – 50% and it is doubtful whether a right of pre-emption is appropriate when the value of the commercial element is so high, (see paragraph 7(vii) above). Anyone for repeal?