
CURRENT ISSUES IN ENFRANCHISEMENT CASES

by

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Leasehold Reform Act 1967, the Landlord and Tenant Act 1987 and the Leasehold Reform, Housing and Urban Development Act 1993 all make provision for buildings with commercial use.

Leasehold Reform Act 1967

This Act originally granted rights only to those tenants who lived in their own homes. Its scope has been markedly widened since, particularly after the abolition of the general residence test in 2002. The original low rent test has gone in most cases, as has the low rateable value requirement. The Act applies to any house held on a lease granted originally for more than 21 years.

Definition of “house” in s. 2 of the Leasehold Reform Act 1967:

2.— Meaning of “house” and “house and premises”, and adjustment of boundary.

(1) For purposes of this Part of this Act, “house” includes any building designed or adapted for living in and reasonably so called, notwithstanding that the building is not structurally detached, or was or is not solely designed or adapted for living in, or is divided horizontally into flats or maisonettes; and—

(a) where a building is divided horizontally, the flats or other units into which it is so divided are not separate “houses”, though the building as a whole may be; and

(b) where a building is divided vertically the building as a whole is not a “house” though any of the units into which it is divided may be.

(2) References in this Part of this Act to a house do not apply to a house which is not structurally detached and of which a material part lies above or below a part of the structure not comprised in the house.

A building partly designed for non-residential purposes may be a house. Since the abolition of the universal residence test in 2002, many buildings not lived in by the lessee have become potentially enfranchisable. In Central London many 18th and 19th Century grand houses are now used wholly or in part as offices or for other commercial purposes.

When there was a residence test, a limited company was unable to satisfy it (s. 37(5)); now there isn't one, the status of the lessee is irrelevant.

In *Boss Holdings Ltd v Grosvenor West End Properties* [2008] 1 WLR 289, a mixed-use building where the residential parts had become so dilapidated that residential use at the date of the claim was not physically possible, the House of Lords held that the building had not lost its residential design and came within the statutory definition of “house”.

In *Grosvenor Estates Ltd v Prospect Estates Ltd* [2009] 1 WLR 1313, the trial judge held that subsequent alterations could change the design for this purpose, but on the facts these had not been sufficient. The Court of Appeal held, reversing the trial judge, that the building was not a house “reasonably so called”, because 88.5% of it could only lawfully be used as offices, with the only permitted residential part being a small flat on the top floor which had to be occupied by someone connected with one of the office uses. The terms of the lease preventing residential use in the great majority of the premises was the decisive factor, although the fact that building was actually used as offices was also mentioned. In the case of *Tandon v Trustees of Spurgeons Homes* [1982] AC 755, Lord Roskill, giving the majority’s judgment in the leading House of Lords case had suggested that the terms of the lease were a relevant factor. The *Prospect* case is the first reported case where it has been held that a building is not a house reasonably so called.

Prospect Estates Ltd, a commercial property investor, was only able to launch an enfranchisement claim at all because of the abolition of the general residence test by the Commonhold and Leasehold Reform Act 2002. It did not have to satisfy the limited residence test now applicable in two exceptional cases, because it did not itself occupy the premises for business purposes, and did not sub-let the flat on a long lease.

The most recent reported cases on this topic are *Hosebay Ltd v Day, Lexgorge Ltd v Howard de Walden Estates Ltd* [2010] 1 WLR 2317, decided by the Court of Appeal. My analysis of them must be circumspect because they are going to be heard by the Supreme Court in May 2012 and I am appearing. In *Hosebay*, H H Judge Marshall QC held that 3 buildings originally built as houses, but now used together as what she described as a “self-catering hotel” were each a house within the meaning of the Act. They were designed for living in, even though the current fittings meant that they were not used for people’s residences. They were reasonably called houses because the

leases permitted residential use; *Prospect Estates* was distinguished on that ground. In the Court of Appeal, Lord Neuberger clarified what he had said in *Boss*. He said that where a building had been adapted from its original design, it was the most recent works of adaptation that would be relevant i.e. that it was possible for a building originally designed for living in to lose its status as a building designed for living in. However, on the facts, the three buildings were adapted for residential use. In the *Lexgorge* case, the building had retained its original design as a residential house, and there was no challenge to it falling within the first limb of the statutory test. It was a house 'reasonably so called' because, although it was used for offices at the relevant date, the lease did not prohibit residential use; indeed the upper floors were required to be used as a maisonette. The *Prospect* decision was doubted, and its *ratio* confined to those leases where residential use was prohibited, or confined to a very small part of the building.

Landlord and Tenant Act 1987 – estate of blocks of flats

Section 1 of the Act defines premises to which the Act applies:

(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.

(3) 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.

Imagine a single freehold title with 4 detached buildings, some containing flats, all of which flats are let on long leases, and a freeholder who wishes to sell his freehold interest as a single transaction. Is he entitled under Part I of the Landlord and Tenant

Act 1987 (“the Act”) to sell the whole of his interest together or does it need to be divided up into parcels of individual blocks.

- (a) By s. 1(2) of the Act, Part I applies to premises if they “consist of the whole or part of a building”. By s. 5(3) of the Act, if the sale by the landlord involves “more than one *building*” the freeholder is obliged to sever the transaction so as to deal with each *building* separately.
- (b) The word “building” is not defined in the Act. It has, however, been considered in a number of reported cases under the Act.
- (c) In *30 Upperton Gardens Management Ltd v Akano* [1990] 2 EGLR 232, the leasehold valuation tribunal (“LVT”) determined an application under s. 13 of the Act where the landlord of 4 separate blocks of flats had disposed of them without offering the tenants the right of first refusal. The LVT held (p. 235J-M, 236J-K) that although each block of flats was a separate building, the draftsman of the Act could not have intended that a building scheme should be split up in order to comply with the provisions of the Act. Although only a decision of an LVT, and therefore merely persuasive, it was referred to in *Long Acre Securities Ltd v Karet* [2005] Ch 61 (see below) and, in effect, approved on different grounds. It should be noted that both sides wished the LVT to deal with the estate as one.
- (d) In *Denetower v Toop* [1991] 1 WLR 945, the premises consisted of two blocks of flats, each containing 4 flats. A roadway runs between the two blocks (p. 949B). The freehold was transferred in a single transaction without offering the tenants the right of first refusal. A single purchase notice under s. 12 of the Act was served claiming both buildings and appurtenant property. Sir Nicolas Browne-Wilkinson V-C assumed (p. 952H, 953G) that the term building in s. 1(2) could apply to more than one separate structure: see the analysis in *Long Acre Securities Ltd v Karet* (above) para. [54]. The report does not suggest that the contrary was argued or suggested. In neither *30 Upperton Gardens* nor *Denetower* was reference made to s. 5(5) of the Act, the “convoluted” (*Long Acre* para. [55]) predecessor of the current s. 5(3).
- (e) *Saga Properties Ltd v Palmeira Square Nos 2-6 Ltd* [1995] 1 EGLR 199 was a decision of the Lands Tribunal, on appeal from the LVT. Again, there had been a disposal in breach of the Act: followed by a purchase notice under s. 12. The landlord appealed contending that one of the main issues was whether 6 Palmeira

Square was a separate building or whether it formed part of 2-5 Palmeira Square. If it was a separate building, there would have been an insufficient number of qualifying tenants in it to acquire No. 6, and the tenants would only be able to acquire Nos. 2-5. If it was not a separate building i.e. Nos. 2-6 were together to be regarded as one building, then there were a sufficient number of qualifying tenants in Nos. 2-6 to acquire Nos. 2-6.

- (f) The Lands Tribunal held that they had no jurisdiction to determine the issue, which was for the court to decide, and not for the LVT or the Lands Tribunal on appeal from the LVT: p. 207G-K. However, they went on to express their view, *obiter*, in case they were wrong as to their jurisdiction. They held that Nos. 2-5 were a separate building from No. 6. The important factors were that there were separate entrances to the two buildings, which were each completely self-contained and completely vertically divided. The Lands Tribunal referred to *Bardrick v Haycock* (1976) 31 P & CR 420, a Rent Act case, in which the Court of Appeal had held that a building \cong was an ordinary English word and could not be given a defined or precise meaning as a matter of law. Cairns LJ said at p. 425:
- “When an Act of Parliament uses the word “building” without defining it there must be some structures or pairs of structures which as a matter of law could be said to be two buildings within the meaning of the Act and some which as a matter of law could be said to be one building.”*
- (g) In that case, there was a main house containing flats and a subsequently constructed extension to the house which was occupied by the landlord. It was held that the extension, was a separate building from the main house. There was no internal communication between it and the main house and it had its own front door.
- (h) *Kay-Green v Twinsectra Ltd* [1996] 1 WLR 1587 was another s. 12 purchase notice case, where the landlord had disposed of several buildings in a single transaction without offering the tenants the right of first refusal. None of the buildings was attached or linked to another. The tenants served a single purchase notice in respect of the landlord=s disposal, the validity of which was unsuccessfully challenged by the landlord. The fact that the tenants included more than one building in their s. 12 notice was attributed by Staughton L.J. (at p. 1604C-D) to the landlord=s failure to serve offer notice under s. 5, and in doing so

to sever the transaction as required by the then s. 5(5) [N.B. now replaced by s. 5(3)]. The ratio of the case is correctly stated at paragraph [60] of *Long Acre*.

Most recently, in *Long Acre Securities Ltd v Karet* [2005] Ch. 61, a decision of the High Court (Deputy High Court Judge Vos Q.C.), the issue concerned the validity of s. 5 offer notices, where a single notice was served on the tenants of four blocks of flats on a residential estate. The landlord obtained a declaration that its notice was valid, notwithstanding that the notice concerned more than one building. The tenants in the different blocks shared certain appurtenant areas which were managed as part of a single estate

It was held that 'building' must have been intended by Parliament to include more than one structure in some circumstances e.g. two structures with a shared access: paragraph [71]. In the particular circumstances of the case, building was held to mean more than one building because the occupants of the flats share the use of the same appurtenant premises: paragraphs [74], [81].

1. The tenants did not appear at the hearing, except that one of them sought to resist an order for costs. Nevertheless, it is a detailed reserved judgment, which considered all the relevant authorities. It has come in for some academic criticism: >Building a case for a single notice= by Douglas Readings, NLJ 23 April 2004, p. 622. One practical consequence of that decision is that a number of qualifying tenants in one block might be deprived of the right of first refusal solely because there are an insufficient number of qualifying tenants in another block sharing appurtenant premises.
2. On the basis of *Long Acre Securities Ltd v Karet* it appears that the test of whether premises are a building under the Act is not a purely physical one in the sense of structural connection. In order for the Act to apply the building must contain flats let to qualifying tenants. The rights given to the tenants (e.g. over parts of the building), and the management of the building are relevant considerations.
3. Let us assume that the flat leases give rights to the lessees over the common parts of the estate including the gardens, roadways and grounds, for the maintenance of which they contribute a service charge. If *Long Acre Securities Ltd*

v Karet is correct, then a single disposal of the Estate would be permitted under the Act. As a decision of the High Court, it binds the county court (*Howard de Walden Estates Ltd v Aggio* [2008] Ch. 26 paras. 86-95) and would be followed in a future High Court case, since it is not *per incuriam*. It would be open to being challenged in the Court of Appeal, and there is a chance that it would then be overruled. Bearing in mind that there is a criminal sanction, what would you advise your client to do?

The fact that more than one property is within the same Land Registry Title or that each of a number of properties have their own separate titles is neither here nor there.

Consider a development which was built at the same time, and where the buildings appear to be separate and detached, but which have an underground car park running beneath all the blocks. I would suggest that it is permissible to treat the whole development as one building; it is not possible to divide the blocks vertically from each other.

Mixed use developments

The particular importance of this in the context of mixed use buildings is that residential blocks may be physically linked in some way to commercial premises in the same development. If the commercial internal floor area exceeds 50% of the whole, then the 1987 Act will not apply at all (s. 1(3)), if the development can be regarded as a single building. When a landlord wishes to sell his interest, he will usually want to dispose of it in one go. He will be able to do so, and without offering the interest to the residential tenants, if the interest is in a single building.

Landlord and Tenant Act 1987 – disposal of part of a building.

Suppose there is a building falling with Part I of the 1987 Act, part of which is commercial premises e.g. a shop on the ground floor. There are 6 flats demised on long leases on the upper floors. Your client, the freeholder, wishes to grant a lease of the ground floor shop. Does he have to offer it to the residential tenants first? A recent High Court decision suggest the answer may be Yes. In *Dartmouth Court Blackheath*

Ltd v Berisworth Ltd [2008] L & TR 12, a lease of parts of a building was caught by the Act. Warren J accepted the tenants' argument that it was necessary to identify the relevant premises that fall within the Act. Once that has been done, a disposal of any part of those premises is subject to the tenants' right of first refusal, unless it is an exempt disposal. The grant of a lease of commercial premises is not exempt. At paragraph 44, counsel for the landlord's argument is referred to, in which he pointed out that the lease of a shop would be caught on this construction and this could not possibly have been intended by Parliament. Warren J accepted the tenants' argument without endorsing, in terms, the consequence concerning the shop lease. It certainly seems surprising that the tenants could obtain a shop lease after it had been granted, putting the shopkeeper out of business. What would you advise your clients to do? The process of offering the lease to the tenants takes a considerable time, and it may well be desirable to let the shop quickly, in November say to catch the Christmas trade. Bear in mind also that it has been suggested that a solicitor acting for a landlord who contravenes the 1987 Act may be guilty of an offence under the Proceeds of Crime Act 2002 (Mixed Use and Residential Tenants' Rights by Dollar and Thompson-Copsey (2009) paragraph 2-06).

Leasehold Reform, Housing and Urban Development Act 1993

Premises to which this Chapter applies

3.—(1) Subject to section 4, this Chapter applies to any premises if—

- (a) they consist of a self-contained building or part of a building;
- (b) they contain two or more flats held by qualifying tenants; and
- (c) the total number of flats held by such tenants is not less than two-thirds of the total number of flats contained in the premises.

(2) For the purposes of this section a building is a self-contained building if it is structurally detached, and a part of a building is a self-contained part of a building if—

- (a) it constitutes a vertical division of the building and the structure of the building is such that that part could be redeveloped independently of the remainder of the building; and
- (b) the relevant services provided for occupiers of that part either—
 - (i) are provided independently of the relevant services provided for occupiers of the remainder of the building, or
 - (ii) could be so provided without involving the carrying out of any works likely to result in a significant interruption in the provision of any such services for

occupiers of the remainder of the building;

and for this purpose “relevant services” means services provided by means of pipes, cables or other fixed installations.

Premises excluded from right

4.—(1) This Chapter does not apply to premises falling within section 3(1) if—

- (a) any part or parts of the premises is or are neither—
 - (i) occupied, or intended to be occupied, for residential purposes, nor
 - (ii) comprised in any common parts of the premises; and
- (b) the internal floor area of that part or of those parts (taken together) exceeds 25 per cent of the internal floor area of the premises (taken as a whole).

(2) Where in the case of any such premises any part of the premises (such as, for example, a garage, parking space or storage area) is used, or intended for use, in conjunction with a particular dwelling contained in the premises (and accordingly is not comprised in any common parts of the premises), it shall be taken to be occupied, or intended to be occupied, for residential purposes.

(3) For the purpose of determining the internal floor area of a building or of any part of a building, the floor or floors of the building or part shall be taken to extend (without interruption) throughout the whole of the interior of the building or part, except that the area of any common parts of the building or part shall be disregarded.

This statute grants to long lessees in premises containing at least two flats the right to acquire the freehold, known as collective enfranchisement. There is an important exception in the case of mixed use buildings. By s. 4 of the 1993 Act, where more than 25% of the floor area of the building is not occupied or intended to be occupied for residential purposes, the right cannot be exercised. In calculating the floor areas, common parts are disregarded throughout the exercise. This means that for buildings where up to 25% of the floor area is commercial, the residential lessees can acquire the freehold. Note that the proportion differs from the 50% in the Landlord and Tenant Act 1987. “Common parts” do not have to be common to both residential and commercial areas: *Marine Court (St Leonards on Sea) Freeholders Ltd v Rother District Investments Ltd* [2008] 1 EGLR 39. So, if one has a corridor leading to several flats only, that will be regarded as common parts and taken out of the calculation. Not less than two-thirds of the flats must be held by long lessees. The Act applies both to a self-contained building and to a self-contained part of a building (s. 3). The former is one that is structurally detached; a self-contained part of a building is one that can be vertically divided and separately redeveloped with separate services. As with the 1987

Act, difficult questions can arise with developments where a number of apparently separate buildings are in some way linked, for example a development where seemingly separate blocks have a single electricity grid or heating system. In *Oakwood Court (Holland Park) Ltd v Daejan Properties Ltd* [2007] 1 EGLR 121, the lessees of a block of flats were unable to acquire the freehold, because a separate boiler served not only their block, Nos. 1-14, but also another one, Nos. 15-30, that was not taking part on the claim. The provision of heating and hot water could not be supplied independently. In such a case, if a residential block is linked to a commercial part, the whole premises might be enfranchisable. Equally, the presence of the commercial part might exclude the whole premises from the 1993 Act if it is large enough.

The landlord in a collective enfranchisement claim may be able to influence whether it proceeds. This is because the tenants are obliged to claim the whole of the freehold. If they acquire it, they will have to pay a price based on its market value. If the building contains significant commercial premises, this will obviously increase the price. Many residential lessees will not wish, or be able to afford, to pay to become commercial landlords. The landlord may, however, seek a 999-year leaseback of any commercial unit, let on a business lease (i.e. one let on a tenancy to which Part II of the Landlord and Tenant Act 1954 applies). He does not have to seek a leaseback; if he does, the commercial unit remains his and the tenants won't have to pay for it. The tenants don't know when they serve the notice of claim where or not the landlord will seek a leaseback. The landlord has to make its election when it serves its counter-notice.

Another important factor arises where the building is subject to a Headlease. The tenants are obliged to acquire any lease intermediate between their flats and the freehold, but only, insofar as it demises the flats and common parts (s. 2). To the extent that a headlease demises non-residential premises, they do not acquire it. This will mean, however, that any commercial tenants will have an enforced change of landlord; whereas previously, their landlord may have been an experienced property company, it could now be an amateur group of residential tenants. Commercial lessees are not given the right to join in a collective enfranchisement claim.

Example

Consider a building containing 12 flats, each of 1500 sq ft in internal floor area (i.e.

18,000 sq ft in all). On the ground and basement floors there are commercial premises comprising 6,500 sq ft. At present the building is not enfranchisable, because 6,500 out of 24,500 sq ft are not residential (which is more than 25%). However, suppose part of the commercial premises (1,000 sq ft) fall vacant. The landlord intends to create a small flat in that vacant part – what is the position? Under s. 4(1)(a)(i) of the 1993 Act, the part in question must not be occupied or intended to be occupied for residential purposes. What level of intention needs to be established? Does planning permission need to be obtained, or does it suffice that it is likely to be obtained if applied for?

A warning for landlords

A recent decision of Morgan J has important implications for landlords seeking to service a counter-notice under the 1993 Act by post. In *Willingale v Globalgrange Ltd* [2000] 2 EGLR 55, the Court of Appeal held that where a counter-notice is not served, the tenants are entitled to acquire the freehold on the terms set out in their notice; there being no discretion to refuse an order. By s. 99(1)(b) of the 1993 Act, a notice may be sent by post. Section 7 of the Interpretation Act 1978 provides that, in such a case, “service is deemed to be effected by properly addressing, pre-paying and posting a letter containing the document and, unless the contrary is proved, to have been effected at the time at which the letter would be delivered in the ordinary course of post.” In *Calladine-Smith v Saveorder Ltd* [2011] EWHC 2501 (Ch), the county court judge found that a counter-notice was posted by the landlord’s solicitor; however, it was not received by the tenant. Morgan J allowed the tenant’s appeal, and held that the contrary was proved under s. 7. Consequently, the tenant was entitled to a new lease on the terms set out in his notice. No application for permission to bring a second appeal was made. This may have been influenced by the small amounts at stake in this case; the tenant’s proposed premium was £5,900, whereas the landlord’s counter-proposal was £9,000. In effect, the risk of using the post was the landlord’s. The lesson to be learned is not to use ordinary post if possible. Do not leave it until the last minute to serve a counter-notice, so that if the post is used, and there no acknowledgement of receipt, another attempt at service can be made.