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The *Commonhold and Leasehold Reform Bill*

HL Bill 51 of 2001-02

The *Commonhold and Leasehold Reform Bill* was presented in the Lords on 21 June 2001 and is due to receive its Second Reading in the Commons on 8 January 2002.

Part 1 of the Bill will introduce a new form of tenure called commonhold.

Part 2 will make key changes to existing leasehold legislation with a view to strengthening leaseholders' rights and assisting those who are unable to covert to commonhold or who do not wish to do so.

The Bill extends only to England and Wales.

Wendy Wilson

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Summary of main points

The *Commonhold and Leasehold Reform Bill* was presented in the Lords on 21 June 2001. This Bill is much the same as the *Commonhold and Leasehold Reform Bill* (with some additional provisions) which fell for lack of time before the 2001 General Election. Debates on the first Bill (as it will be known in this paper) are referred to frequently throughout this paper.

Part 1 of the Bill will introduce a new form of tenure called commonhold. The Government believes that commonhold will provide a better system for the future ownership and management of blocks of flats and other interdependent buildings with shared services and common parts. Commonhold will be available for new developments and the Bill contains provisions which will allow existing leaseholders to convert to commonhold. However, conversion from leasehold to commonhold will only be possible where all of the leaseholders agree to participate and buy out any other interests involved.

The principle of commonhold has broad support across the political parties; the previous administration twice consulted on draft Commonhold Bills and the genesis of the current proposals can be traced back to 1965. The Labour Government arrived in office with a manifesto commitment to introduce commonhold ownership: Part 1 of this Bill will honour this commitment.

Part 2 of the Bill will make key changes to existing leasehold legislation with a view to helping the large number of leaseholders who are unable to convert to commonhold or who do not wish to do so. The main changes contained in Part 2 will:

- introduce a new right to manage, which will enable leaseholders to take over the management of their building without having to prove fault on the part of the landlord or pay him any compensation;
- make enfranchisement easier for both leaseholders of flats and leaseholders of houses;
- make lease extensions easier to obtain;
- allow leaseholders of houses who have previously extended their lease the right to buy the freehold of their property;
- improve the rights of those who have inherited a leasehold house from a deceased leaseholder who qualified for the right to extend and/or enfranchise;
- strengthen leaseholders' rights against unreasonable charges levied under their lease;
- strengthen accounting rules for leaseholders monies;
- require landlords to hold service charge funds in designated separate client accounts;
- make lease variations easier to obtain;
- strengthen the right to seek the appointment of a new manager;
- prevent landlords taking any action for unpaid ground rent unless it has been first been demanded in writing;
- prevent landlords from starting forfeiture proceedings until facts have been determined; and

- consolidate and amend the existing Leasehold Valuation Tribunal provisions to make the Leasehold Valuation Tribunals more effective and efficient.

The Government believes that these reforms will redress the uneven balance between landlords and leaseholders and give leaseholders a greater degree of control over the management of their homes. These reforms are also intended "to prevent unreasonable and oppressive behaviour by unscrupulous landlords, and provide flexibility to tackle any new forms of abuse that may arise in the future."

The Bill extends only to England and Wales.

CONTENTS

I Part 1: Commonhold

A. What is commonhold ownership?

The regulatory impact assessment (RIA) that accompanied the first *Commonhold and Leasehold Reform Bill*[1] described Commonhold as:

> …the name given in this jurisdiction to a scheme widely used throughout the rest of the world with greater or lesser degrees of variation. It provides for multiple occupation of developments, such as blocks of flats, or mixed flats and shops, or business parks in which unit owners have an interest in their unit of occupation, whatever that may be, which is closely analogous to a freehold interest. A body corporate, the commonhold association, made up exclusively of unit holders, owns and manages the common parts of the development, which may be no more than hallways and stairs, but might run to parks, sports halls, lakes, etc.

In *Commonhold Law: problems and potential solutions,*[2] Katharine Rosenberry describes the four types of commonhold communities currently in use around the world: condominiums, co-operatives, planned communities and master planned communities.

1. Condominium

In the condominium or strata scheme the unit owner owners a freehold interest in a unit coupled with a tenant-in-common interest in the common area, and perhaps an interest in an exclusive use common area.

2. Housing co-operative (company titles scheme in New South Wales)

Under this scheme the corporation owns the entire structure and each owner has the exclusive right to possess a portion of the building coupled with an interest in the corporation. This form of ownership is similar to a block of flats where all of the tenants have purchased their flats. Housing co-operatives in the US are concentrated in New York and Chicago; these days developers rarely create them. In New South Wales the association that owns the building is a traditional company and the 'owners' are shareholders. This means that they are governed by traditional company law. Housing co-operatives have been overtaken by the development of condominium and planned community law.

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1 This Bill fell for lack of time before the 2001 General Election (HL Bill 11 of 2000/01). Henceforth this Bill is referred to in this paper as the first Bill.

2 Joseph Rowntree Foundation, 2000

3. Planned community

The unit owner owns a freehold interest in a separate area, sometimes called a unit or lot, coupled with an interest in the association. The association owns the common area. The unit owner may also own an interest in a proportion of the common area that is called exclusive use common area. This is a portion of the common area reserved for the use of one or more, but not all, of the owners, eg patios, balconies and parking spaces.

4. Master planned community

This is a combination of one or more of the above. This form of ownership is viewed as particularly valuable in a mixed-use building where it is desirable to have one association for the commercial property and one for the residential property. Each association has its own common area and rules and each is also subject to the rules of the master association that also generally owns common property. In this case both the commercial and residential owners have voting rights in the master association.

B. Commonhold: the rationale

The consultation paper that accompanied the publication of the *Draft Commonhold and Leasehold Reform Bill*,[3] (published in August 2000), summarised the problem with the current system of ownership in blocks of flats:

> In England and Wales, there are two ways to own land, freehold and leasehold. Each has its advantages and disadvantages in particular circumstances. Freehold comes closest to absolute ownership. Leasehold confers ownership for a temporary period, subject to terms and conditions contained in the contract, or lease.
>
> A covenant is a promise contained in a deed, such as a deed passing ownership of property from one person to another. There are two types of covenant: the positive covenant, which is a promise to do something, such as to pay rent or to keep the property in repair, and the restrictive covenant, which is a promise not to do something, such as cause a nuisance to neighbours. For historical reasons, positive covenants cannot apply to freehold land once the first buyer of the property has sold it on. However, both positive and restrictive covenants apply to leasehold property.
>
> The problems with covenants are accentuated in the case of blocks of flats, where each flat will often depend on its neighbour for support and shelter, and the very stability of the building depends on the proper maintenance and repair both of the individual flats and the common parts. This means that, where it is desired to set up a scheme to allow for ownership of interdependent properties and for the management of the common parts and facilities, the scheme must, today, be based

[3] Cm 4843

> on leasehold ownership. There is no satisfactory scheme at present that would allow for freehold ownership in such circumstances.
>
> As long term residential leasehold has become more and more widely discredited,[4] pressure has grown for the Government to bring forward a scheme which would combine the security of freehold ownership with the management potential of positive covenants which could be made to apply to each owner of an interdependent property. That scheme is commonhold.[5]

David Clarke, Professor of Law at Bristol University and a member of the Commonhold Consultation Working Group, has argued that commonhold is not just about finding a long-term solution to the problem of long leases in London and the South East:

> Commonhold should be viewed more positively. Modern society demands flexible legal solutions for living and working in proximity which demand the sharing of facilities. Condominiums and strata title schemes exist in nearly every other major jurisdiction. We need to provide the same flexibility and choice.[6]

The principle of commonhold has broad support across the political parties; the previous administration twice consulted on draft Commonhold Bills and the genesis of the current proposals can be traced back to 1965.[7] The Labour Government arrived in office with a manifesto commitment to introduce commonhold ownership; Part 1 of this Bill will honour this commitment. During the debate on Second Reading in the Lords on the first Bill the Lord Chancellor, Lord Irvine of Lairg, said that he did not expect the commonhold provisions to be the subject of controversy 'either in this House or in another place.'[8]

Commonhold tenure is viewed as offering several advantages over the current leasehold system. The September 2000 issue of Lovells' property newsletter identified the following perceived advantages of commonhold:

> Commonhold will address the problem of lessees being beholden to an absentee landlord who cannot be bothered to carry out building maintenance and management, or who is more interested in trying to make a profit at their expense.
>
> Commonhold will also remove the problem of leasehold property being a wasting asset. Commonholders will each have a perpetual interest, effectively akin to a freehold, in their individual unit.

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4 More detailed information on the problems associated with leasehold ownership is contained in Part II of this paper.

5 Cm 4843, para 1.2

6 Commonhold & Leasehold: the new law, Conference, 28 March 2001 (Jordans)

7 Cmnd. 2719. The consultation paper that accompanied the publication of the *Draft Commonhold and Leasehold Reform Bill* (Cm 4843) contains a brief history of efforts to amend the law of positive and restrictive covenants and introduce commonhold tenure at pages 79-8.

8 HL Deb 29 January 2001 c 455

> Standardised commonhold constitutional documents should be of general benefit.

However, the newsletter went on to point out that commonhold would not make it any easier to live alongside difficult neighbours who are noisy or who refuse to pay reasonable service charges:

> Large multi-occupied buildings of a certain age are expensive to maintain. Commonhold will not make any difference to this, but unit holders may feel happier about spending large amounts of money on building maintenance if they feel they are in control and no one is trying to rip them off.

The British Property Federation's (BPF) briefing note on commonhold also emphasised that it is not a panacea for problems associated with residential long leasehold:

> The demands, problems and requirements of community living and block management will be the same, regardless of the legal basis of which the property is owned.[9]

C. The Bill in outline (clauses 1-68)

The Explanatory Notes to the Bill provide a commentary on the purpose of each clause.[10] This paper does not duplicate that work: instead it aims to provide an outline of the Bill with references to aspects that were debated in the Lords. Some of the references in this paper refer to Lords debates on the first *Commonhold and Leasehold Reform Bill* which fell for lack of time before the 2001 General Election. During the Committee stage of the current Bill Lord Goodhart advised that the Opposition had cut back on the number of amendments tabled because of the lengthy debates that had taken place on the Bill's predecessor.[11] Therefore, the debates on the first Bill still provide a useful insight into some of the current Bill's clauses.

Section **D** of the paper focuses on the areas of Part 1 that have given rise to most discussion. Part 1 of the Bill would establish the framework within which commonhold schemes will be developed. During the debate on Second Reading in the Lords on the first Bill the Lord Chancellor said that although certain fundamental matters were set out on the face of the Bill, "much of the detail of the commonhold scheme in its day to day operation will be in regulations."[12] The stated purpose of this is to ensure that changes to matters of detail, should they arise, can be made quickly.[13]

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9 11 February 2000
10 HL Bill 51 - EN
11 HL Deb 16 October 2001 c 482
12 HL Deb 29 January 2001 c 456
13 *ibid*

In addition to the Bill and regulations made under it, other key documents for understanding how commonhold will operate are the Commonhold Community Statement (CCS) and the Memorandum and Articles of Association of the Commonhold Association (M&A), drafts of which have been made available to Peers as the Bill progressed through the Lords.[14]

It is worth keeping in mind the fact that the Government envisages that it will be easier to introduce a commonhold set-up on a new development. Conversion to commonhold by existing leaseholders is not expected to be the norm.[15]

1. The nature of a commonhold

The Bill would provide for land to be commonhold if the freehold estate is registered as an estate in commonhold land **(clause 1(1)(a))**. Thus commonhold will not be a new estate in land necessitating changes to the *1925 Law of Property Act* but David Clarke, Professor of Law at Bristol University and a member of the Commonhold Consultation Working Group, has suggested that it will be "a distinct sub-species."[16] Because the land will already be registered with HM Land Registry a second registration process is, in essence, being created. **Clauses 2-5** would provide for the commonhold registration process.

Clause 1 would define commonhold land in terms of certain key elements necessary to its creation:

(a) the freehold estate in land must be registered as a freehold estate in commonhold land;
(b) the land must be specified in the memorandum of a Commonhold Association (CA) as the land in relation to which the CA exercises functions; and
(c) a Commonhold Community Statement (CCS) must exist and make provision for the rights and duties of the CA and the unit holders.[17]

A commonhold development would consist of two or more parcels of land, whether or not contiguous, but a single CCS will have to make provision for all of the land **(clause 56)**.

Clause 4 and schedule 2 would define land that cannot be commonhold land. This would include:

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[14] At the time of writing the latest (fourth) draft of these documents had been issued by the Lord Chancellor's Department (HDEP 2001/303).
[15] This aspect of the Bill is discussed in detail on pages 29-33
[16] Commonhold & Leasehold: the new law, Conference, 28 March 2001 (Jordans)
[17] Clause 1(1) and (2)

- leaseholds;
- flying freeholds (see below);
- agricultural land; and
- contingent freehold titles under specified Acts.

Clause 4 and paragraph 1 of schedule 2 to the Bill would provide that land above ground level cannot be the subject of an application to register a commonhold unless all of the land between ground level and the raised land is the subject of the application. This situation might arise where a block of residential flats sits on top of a block of commercial premises where the two parts are in different freehold ownership. This is referred to as a "flying freehold." The Bill would not allow the formation of a commonhold of only the residential units in this example.

In Committee, on Report and also at Third Reading, Lord Kingsland moved amendments to **schedule 2** of the Bill to allow for the conversion or development of "flying commonholds."[18] On all occasions Lord McIntosh of Haringey or Baroness Scotland of Asthal, for the Government, referred to the fact that the Law Commission was reviewing the question of positive covenants affecting land and asked that this technically complex matter be left to the Law Commission to determine. During the debate on Third Reading Baroness Scotland advised that the Law Commission does not expect to go out to consultation on land obligations before 2003 because its work is contingent, to an extent, on the outcome of Part 1 of this Bill.[19]

The essential features of a commonhold would be:[20]

- a commonhold association (CA) which must be a company limited by guarantee; only the unit holders will be able to be members of the company although the developer will be a member at the outset;
- a CCS;
- two or more commonhold units with separate freehold titles;
- unit holders, freehold proprietors of a commonhold unit who are, and can be (once the development is completed) the only members of the CA.

Draft commonhold Bills had, in the past, provided that all buildings within the commonhold had to be structurally complete, or have reached a required stage of construction, before an individual unit could be transferred to a unit holder. The current Bill does not specify this. Instead, on the sale of the first unit, the CA would be registered and the CCS would come into effect.[21] Developers will have more freedom before this

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18 HL Deb 16 October 2001 cc 498-9; HL Deb 13 November 2001 c 469; HL Deb 19 November 2001 c 943

19 HL Deb 19 November 2001 c 944

20 Defined in clause 1(3).

21 Clause 7(3)

point but Professor David Clarke has pointed out that up until this point, the first purchasers in a new commonhold will need to rely on their legal advisers and the CCS for protection where promised facilities do not exist at the time of purchase.[22]

2. Registration

Clauses 2-5 would provide for the registration process. The CA with its common parts and the associated units would be registered at HM Land Registry. In order to register, the developer of the commonhold development or the sponsor of a converting development would be required to present HM Land Registry with the Memorandum and Articles (M&A) of the association and the Commonhold Community Statement (CCS).[23] The consent of anyone with an interest in the land would have to be sought and also supplied to the Land Registry. Once the required documents are produced (and certified to confirm that they comply with the relevant regulations) the commonhold would be registered.

Clause 3 is about ensuring that all those with legitimate interests in the land which it is proposed to register as commonhold consent to the change of status. In Grand Committee on the first Bill Lord Bach, for the Government, rejected an amendment to omit proprietors of a charge as a class of person from the list of those whose consent would be necessary before registration of a commonhold could take place.[24] He gave an example where consent under **clause 3(2)(e)** might be deemed to have been given, ie "where a number of notices have been served but not responded to."[25]

Government amendments to **clause 3** were moved (and agreed) on Third Reading to bring it in line with provisions contained in the *Land Registration Bill* on the registration of leases for seven or more years.[26]

Clause 6 would provide a mechanism for the rectification of errors in the registration of a commonhold. In Grand Committee on the first Bill Lord Kingsland questioned why the existing powers of the Chief Registrar to rectify errors would not be adequate to deal with this situation.[27] Lord Bach responded:

> **Lord Bach:** The two amendments would weaken a control which we believe would help to prevent fraudulent or reckless applications for the registration of commonhold. Perhaps I may remind the Committee that under the clause as it stands the three circumstances in Clause 6(1) which would trigger the use of the court to make a declaration are, first, that the application did not accord with Clause 2; secondly, that the certificate to be given by the directors of the

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22 Commonhold & Leasehold: the new law, Conference, 28 March 2001 (Jordans)
23 This will set out the rules and regulations of the development (tailored to the particular dwelling).
24 HL Deb 20 February 2001 CWH 13
25 *ibid*
26 HL Deb 19 November 2001 cc 907-8
27 HL Deb 20 February 2001 CWH 22

> commonhold association was incorrect; or, thirdly, that the registration itself contravenes some provisions of Part I of the Bill. Our case is that none of those possibilities is a trivial matter and we believe that none of them is easily likely to happen by accident. That is why we have specified that it should not be possible to rectify the register, but that the courts should be invited to declare that the estate should not have been registered as commonhold with all that flows from that.[28]

During the Report stage of the first Bill Lord Kingsland sought to enable the Chief Registrar to correct 'minor' errors and those where all parties agree to the rectification. Once again, Lord Bach argued that such an amendment would weaken controls over fraudulent or reckless applications to register commonhold developments.[29]

Clauses 7, 8, and 9 would provide for the effect of registration in different development circumstances. These clauses make a broad distinction between developments without occupiers, whether built afresh or re-developed whilst vacant, and those with existing occupiers.

Clause 10 would make provision for dealing will liability for extinguished leases. A new clause 10 was inserted by the Government at Third Reading because it was felt that the existing clause left some doubt as to who would compensate a leaseholder whose lease was extinguished if there was a consenting freeholder but no superior leaseholder:

> New Clause 10(2) puts it beyond doubt that, where there is more than one leaseholder who is required to consent under Clause 3 and does so, it is only the consenting leaseholder most proximate to the extinguished leaseholder to whom the extinguished leaseholder can look as being liable for any loss.
>
> The new Clause 10 makes it clear, in Clause 10(4), that the holder of the extinguished lease would look to the freeholder as the person liable for loss. I beg to move.[30]

The Government agreed to consider the position where a liquidator or receiver exercises the right to consent (to a change of status) under **clause 3** where there is a chance that they will be unable to fulfil their obligations to compensate the extinguished leaseholder under **clause 10**.[31]

Clause 62 would give the Lord Chancellor and Secretary of State joint power (except in relation to compulsory purchase) to make rules governing the registration of commonhold land and the procedures to be followed in relation to commonhold registration documents. These regulations would be subject to the negative resolution procedure in both Houses.

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28 HL Deb 20 February 2001 CWH 22
29 HL Deb 10 April 2001 c 1084
30 HL Deb 19 November 2001 c 908
31 HL Deb 19 November 2001 c 908-9

3. Units and unit-holders

It is the Government's intention that the CCS should come into force as soon as the first unit is sold and that it will govern the management of the commonhold from that time.[32] The CCS will have to provide for at least two units and must define the extent of each unit.[33] The definition will have to refer to a plan,[34] to be included in the CCS; regulations will prescribe the nature of the plan.

A unit will consist of two or more areas that need not be contiguous. Units need not contain all or any part of a building: a unit could be a garden or a car parking space.[35]

A unit-holder will be the person who is entitled to be registered as the proprietor of the freehold estate in the unit (whether or not s/he is actually registered). The definition of a unit-holder in **clause 12** has been phrased to ensure that when there is a gap between completion of a sale of a unit and its registration at the Land Registry, the transferee will be the unit-holder.

When a unit is transferred to a unit-holder s/he will be entitled to become a member of the Commonhold Association (CA).[36] Unit-holders will not be able to resign from membership of the CA unless they are members during the pre-commonhold or transitional periods.[37]

Clause 13 would define joint unit-holders and distinguish between circumstances in which their rights and responsibilities will be joint and those where they will be joint and several. Paragraph 8 of **schedule 3** would provide for the nomination of one joint unit-holder to be a member of the CA; if there is no nomination the member will be the party whose name is first on the register. Professor David Clarke believes that this could give rise to conflict in the future;[38] for example, it is not inconceivable that joint unit-holders may have different views on the direction the CA should take, but only one of them will be a CA member.

a. Transfers of ownership

It would not be possible to place a restriction on the transfer of a unit by a unit-holder in a CCS **(clause 15)**. A transfer would be widely defined and would cover more than a sale of a unit. An incoming unit-holder would be required to inform the CA of a transfer **(clause 15(3))**; regulations would prescribe the form of this notice.

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32 HL Deb 16 October 2001 c 504
33 Clause 11
34 Clause 11(3)
35 Clause 11(4)
36 Paragraph 7 of schedule 3
37 Paragraph 13 of schedule 3
38 Commonhold & Leasehold: the new law, Conference, 28 March 2001 (Jordans)

During Committee Lord Williams of Elvel moved an amendment to **clause 15** to ensure that any debts and arrears due to the CA must be paid by the vendor on transfer of the unit.[39] Baroness Scotland replied that there was a wide range of debt collecting machinery available to the CA and that the Government was "reluctant" to set up a special debt collection process that would apply in the commonhold context alone.[40] The Baroness agreed to consider an amendment that would put beyond doubt the fact that directors of a CA could include in their annual estimate a sum up to the value of an amount owed by a defaulter, provided that they had taken reasonable steps to recover the loss from the defaulter.[41] This would enable the CA to cover the outstanding sum between them if they so wish. However, the matter was not returned to on Report or Third Reading.

Clause 16 would set out the effect of a transfer:

- all rights and duties would affect the new unit-holder in the same way as the former;
- there would be no continuing rights or liabilities on the transferor;[42]
- existing rights and liabilities incurred or acquired before the transfer would continue.

b. Rules and restrictions not applicable to other freeholds

Clause 14 would provide that a CCS must make provision for regulating the use to which units may be put (eg whether they should be for residential use only) and impose duties on the CA or unit-holder in respect of insurance, repair, and maintenance of each unit.[43] There would be flexibility to provide; for example, that unit-holders must take out insurance on the fabric of their flats whilst making the CA responsible for insuring and maintaining the balconies.

Clause 17 would provide for leasing restrictions on residential units. *The Explanatory Notes* to the Bill state:

> Clause 17 places one of the few restrictions that the commonhold scheme requires on the ability of a unit-holder to treat his unit as though freehold.[44]

Regulations would provide the detail of this clause. This provision is controversial and is discussed in section **D.4** below.[45]

Non-residential leases would take effect subject to the terms of the CCS **(clause 18)**. **Clause 19** would enable the making of regulations and provisions in the CCS that would

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39 HL Deb 16 October 2001 cc 504-5
40 HL Deb 16 October 2001 cc 509-10
41 HL Deb 16 October 2001 c 511
42 It will not be possible to alter this by agreement.
43 Clause 67(2) would define the duty to insure and maintain a property.
44 Bill 51-EN para 65
45 See pages 39-40

impose obligations on tenants of units. For example, clause 19(2) would allow regulations to specify that tenants must pay the CA or another unit-holder sums due to be paid by the tenant's landlord unit-holder under the terms of the CCS.

The first Bill originally provided for no restriction in the CCS on the creation, grant or transfer of an interest in, or a charge over, a unit by virtue of **clause 20**, but the creation of an interest in a unit would have needed the CA to be a party to it, or to have given its consent in writing. In Grand Committee on the first Bill Baroness Gardener of Parkes moved an amendment to clause 20 in order to clarify what was meant by an "interest" and why the CA's written consent would be required.[46] Lord Richard suggested that the definition of an interest in clause 20(3) should be confined to interests that would affect the interests of other commonhold unit-holders. Lord Goodhart asked the Government to consider whether the restriction would affect a unit-holder's right to grant a tenancy without the unanimous consent of the CA. Lord McIntosh, for the Government, agreed to examine the points made.[47] On Report the Government moved several amendments to clauses 20 and 21 of the first Bill.

During Committee on the current Bill Baroness Scotland noted that the Government had recognised that the original restrictions on the creation of interests in commonhold units had been "unnecessarily stringent" and that amendments had been tabled to lift them. Under the current Bill's provisions unit-holders would be able to create an interest over part of a unit, for example to rent out an unused garage, and to grant "allowable" leases of commonhold units without the consent of the CA. The Government resisted amendments that would have made it possible to create a charge over a part-unit:

> It is still our intention that charges over part-units should not be possible and that is for reasons which noble Lords have already heard.
>
> A charge over a part unit, should it prove necessary in due course to enforce, would result in a change being required to the commonhold community statement, which would not be under the control of the commonhold association. We believed that we went more than half way to meet the noble Lord on the previous occasion. I am sorry to see that these amendments have come back.
>
> The provisions of Clause 20, as they presently stand, represent a considerable relaxation to the restrictions in the previous version of the Bill prior to Report. In the circumstances, I hope that the noble Lord will feel able to withdraw his amendment.[48]

Clause 21 would prohibit charges over part-units and make provision to prohibit the creation of prescribed types of interests in part-units.

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46 HL Deb 20 February 2001 CWH 50
47 *ibid*
48 HL Deb 16 October 2001 cc 519-20

A further Government amendment was tabled to clause 20 during the Report stage of the first Bill to change the basis on which the CA would vote to be a party to the creation of an interest, or could give its consent to such a creation. The original Bill provided for unanimity but the amendment provided for a special resolution of 75 per cent of the CA members. This has been retained in the current Bill.

Changes to the size of a unit would require the consent of the unit-holder **(clause 22)** and the consent of chargees **(clause 23)**.

c. Share in the commonhold association

Each unit-holder would be a member of the CA but the percentage allocation to a commonhold unit:

- for income expenditure, ie the commonhold assessment **(clause 37(2))**; and
- for reserve fund purposes **(clause 38(3))**

must be specified in the CCS.

4. Common parts and limited use areas

a. Ownership

Any part of the land that is not designated as a commonhold unit by the CCS would be a common part **(clauses 1(2) & 24)**. The CCS would be able to specify parts of the common parts as "limited use areas" **(clause 24(2))**. A limited use area would form part of the common parts but might be limited to the use of a single unit-holder, eg a balcony to which the only access is through the unit in question.[49]

b. Use and maintenance

The CCS would be required to provide for the regulation of the use of the common parts. Mandatory provisions in the CCS would provide that the CA must insure, repair and maintain these parts.

c. Transactions

The CA would have freedom to transfer any part of the freehold estate in the common parts **(clause 26(1)(a))**, ie to sell part of the common parts or create an interest over any part of the common parts.

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[49] HL Bill 51– EN para 73

d. Charging of common parts

Both the draft 1990 and 1996 commonhold Bills would have prevented charging of the common parts and would have protected the land vested in the CA from being taken in execution of judgements. The current Bill would make similar provision but the question of whether CAs *should* be able to borrow on the security of part of the common parts and how this might be regulated, was an issue for consultation.

Professor David Clarke describes the Bill's position as a "compromise."[50] It will not be possible to create a charge over a common part and attempts to do so will be of no effect under **clause 27(1-2)**. However, there would be an exception for legal mortgages that receive unanimous approval before creation **(clause 28)**.

In Committee Lord Kingsland raised the question of compensation for chargees in relation to the extinguishment of existing charges over commonhold land insofar as they relate to common parts:

> It seems only just and consistent with Article 1 of the first protocol of the European Convention on Human Rights, which, as the Minister knows, refers to the peaceful enjoyment of property, that a chargee can get fair compensation or adequate substituted security before his charge over common parts is extinguished. I beg to move.[51]

Baroness Scotland, in response, said that the arrangements made between the applicant for registration and the chargees as to compensation or substitution of security would be "a matter to be sorted out between them."[52]

e. Additions to the common parts

Clause 29 would provide for the registration of the CA as the owner of common parts when new land is added to them. The CCS would have to be amended by the CA **(under clause 32)** and submitted to the Registrar.

5. The Commonhold Community Statement (CCS)

This key document would be governed by provisions in **clauses 30-32**. The CCS would describe the physical attributes of the development and contain the rules and regulations by which the commonhold would be conducted. It is intended that the CCS will be in a prescribed form but there would be flexibility to take account of the different nature of certain blocks. Clause 30 would provide for core provisions to be included in the CCS.

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50 Commonhold & Leasehold: the new law, Conference, 28 March 2001 (Jordans)
51 HL Deb 16 October 2001 c 521
52 HL Deb 16 October 2001 c 521

The CCS may provide for positive duties, such as payment of money, giving notice, granting rights of access and providing for rights of indemnity. It must impose obligations in respect of insurance, repair and maintenance of the units and the common parts. Equally, it will be able to impose restrictions in relation to use, alterations and causing a nuisance.

During Committee and on Report Lord Williams of Elvel and the Earl of Caithness moved amendments to the Bill to ensure that the CA would be responsible for repair, maintenance and insurance of the structure and common parts of the building.[53] This matter was also discussed during the Report stage of the first Bill. There was concern that by making the balance of the structure that is not maintained or insured by the unit-holder the responsibility of the CA, that the Bill was not precise enough in this important area:

> When one comes to repair and maintenance, the position is unsatisfactory and not sufficiently clear. Perhaps I may give the example of a floor between two units. Who is responsible for the load-bearing capacity of the floor? It may be that the unit-holder is responsible for both the plaster to the ceiling and the paintwork or wallpaper up to it and the unit-holder above is responsible for the timber floorboards. But we need to be absolutely clear that it is the commonhold association that is responsible for the structure of the floor.[54]

Lord Macintosh of Haringey rejected attempts to amend the definition of the structure and common parts in order to clarify who is responsible for insurance issues:

> Everything within the curtilage is either part of the unit or in common. Therefore, insurance policies will have to be formulated in such a way that they cover everything which falls into one or other of those categories.[55]

The CCS must make provision for regulating the use of the commonhold units **(clause 14(1))** and the use of the common parts **(clause 25(a))**. In Grand Committee and during the Report stage of the first Bill Lord Kingsland moved an amendment to clause 14 to include provision for upgrading or improvements in the CCS. Lord McIntosh advised that unit-holders would be free to carry out improvements by agreement and that "it would not be helpful to require more of them."[56]

The CCS would have to set out how it could be amended. Amendments to a CCS would be governed by regulations made under **clause 31**. All amendments would have to be registered at the Land Registry before taking effect **(clause 32)**.

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53 HL Deb 16 October 2001 cc 499-500 & HL Deb 13 November 2001 c 472
54 HL Deb 10 April 2001 cc 1087-8
55 HL Deb 13 November 2001 c 472
56 HL Deb 10 April 2001 cc 1091-2

6. The Commonhold Association (CA)

Clauses 1(1)(b) and **33** would provide that there must be a CA. The CA would own and manage the common parts of the commonhold development. It would be a private company limited by guarantee[57] with its members consisting exclusively of all the unit-holders in the development. **Schedule 3** would specify membership of the CA.

The question of whether a private company limited by guarantee is the appropriate structure for the CA was debated during the Committee stages of the first and also the current Bill. This debate reflected the views of some respondents to the draft Bill who expressed concern about the use of a corporate structure for all flat management operations. This issue is discussed in more detail in the section **D.3**.

The object of the CA would be to exercise its functions in relation to specified commonhold land. The form and content of the company's Memorandum and Articles (M&A) would be specified in **paragraph 2 of schedule 3**. Some of the provisions of the *Companies Act 1985* would be dis-applied (schedule 3 paragraph 4). As with any company, the CA would need to have directors and a secretary.

The directors would be subject to standard company law requirements but would have specific duties imposed by **clause 34**, ie:

- facilitating the exercise of the rights of each unit-holder and the enjoyment of freehold estate in the unit;
- remedying the failures of unit-holders; and
- using discretion not to enforce any breaches "if they reasonably think that inaction is in the best interests of establishing or maintaining harmonious relationships between all the unit-holders." This discretion should not be exercised if to do so would cause any unit-holder (other than the defaulter) significant loss or disadvantage.

Lord McIntosh of Haringey explained the purpose of clause 34(3) in Grand Committee on the first Bill:

> Clause 34(3) is designed to be a safety valve. If the directors of the association, acting with the best interests of the association in mind--as they are bound to do by virtue of their office--genuinely believe that inaction in the face of a complaint is more likely than not to establish or maintain good relations between the unit-holders, that permits them to exercise some discretion. They may legitimately refuse to take formal action against a unit-holder who hangs out the washing on a Sunday afternoon in contravention of the CCS, thinking instead that a quiet informal word with the unit-holder, perhaps when meeting in the lift or over coffee, would be more conducive to good relations than the legalistic step of issuing the notice that they would be entitled to serve. Therefore, nothing is taken

[57] The guarantee would be £1.

> away but something is added. In answer to the noble Earl, Lord Caithness, that does sit with the directors' normal fiduciary duties; it will operate side by side. It will not be possible to decline to take action where inaction will damage the company or unfairly prejudice its members, or any class of them. Amendment No. 51, therefore, misses the point that there is an opportunity on the face of the Bill for directors of the association, who must always have the best interests of the association in mind, to use some discretion in order to help promote good relations between the unit-holders; in other words, to exercise people rather than business skills. After all, without good relations and goodwill no amount of efficient running of the association and serving of notices will make the commonhold a good place in which to live, and that is what Part I of the Bill is about. With some reluctance, we believe that we are better off with the Bill as it stands
>
> .

The clause was later amended by the Government to ensure that the discretion not to act is not used where it would cause significant loss or disadvantage to other unit-holders. In Grand Committee on the first Bill Baroness Hamwee sought an assurance that clause 34(3)(a) would not override directors' duties under the Companies Act; Lord Bach responded that the Government did not believe it would.[58]

Also on the first Bill, Lord Kingsland moved amendments on Report to disqualify a director from taking part in the decision making process under clause 34(3)(a) where he or she is a defaulter, and to remove the requirement that regulations would make provision for a tenant of a let unit to enforce a duty against another tenant unit-holder. He said that enforcement of obligations should remain between unit-holders and the CA.[59] In response Lord Bach pointed out that directors are under a duty to act for the good of the company and not place themselves in a position where there is a conflict of interest. There is a duty to inform fellow board members should a conflict of interest arise. Lord Bach said that tenants of unit-holders would be able to enforce obligations "to balance the fact that a tenant would be subject to the terms and conditions of the CCS."[60]

The voting arrangements at meetings of the CA would be governed by **clause 35**. In general, the usual rules for company meetings would apply. But where the passing of a resolution is required it will only be satisfied if every member is given the opportunity to vote in accordance with the company Memorandum & Articles (M&A) and the Commonhold Community Statement (CCS) (clause 35(2)-(3)). A unanimous resolution would be achieved when every member *who casts a vote* votes in favour (clause 35(4)).[61]

Clause 36 would provide for regulations to be made covering the exercise or enforcement of a right or duty imposed or conferred by the CCS, the M&A or the Bill. Provision could

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58 HL Deb 10 April 2001 c 1113
59 HL Deb 10 April 2001 c 1112
60 HL Deb 10 April 2001 c 1114
61 The draft articles of the CA suggest a quorum for meetings of 20% of the members of the CA.

be made to require compensation to be paid where a right is exercised or a duty not complied with; for the recovery of costs for work carried out to enforce a right or duty; and for the enforcement of terms and conditions. In cases of late payment provision may be made for the payment of interest (clause 36(3)(b)).

In Grand Committee on the first Bill Lord Kingsland moved an amendment to enable a tenant to pay monies owed on the unit to the CA, if his landlord (the unit-holder) is in default, and to offset this sum against money owed to the landlord to avoid the risk of double payment.[62] Lord McIntosh, for the Government, rejected this amendment but agreed to consider an amendment that would provide for regulations to set out how compensation should be calculated and to cover the issue of interest in the event of late payment.[63] Such an amendment was moved by Lord Bach on Report[64] and this provision is included in the current Bill

The CCS would have to make provision to:

- require an annual estimate of income by the company directors to meet the expenses of the association **(clause 37(1)(a))**;
- enable the directors to make additional estimates from time to time **(clause 37(1)(b))**;
- specify the percentage of any estimate made that is to be allocated to each unit **(clause 37(1)(c))**;
- require each unit-holder to make payments in respect of the percentage allocated **(clause 37(1)(d))**;
- require notices to be served specifying the payments required and the date on which payment is due **(clause 37(1)(e))**.

The percentages would have to add up to 100 but some units could pay nothing because it would be possible to specify 0% for any unit.

The CCS would be able to provide for (and regulations may be made to require[65]) the establishment of one or more repair and maintenance funds **(clause 38)**. These funds would be used to cover finance for common parts or for the commonhold units. Where the CCS does make provision for a reserve fund it would have to make provision for levies to be set from time to time that specify a percentage for each unit.

The fact that a reserve fund could be used for the upkeep of commonhold units was questioned in Grand Committee on the first Bill. Lord Bach explained that a commonhold unit may be owned by the CA and used for a caretaker or as office accommodation and

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62 HL Deb 27 February 2001 CWH 82
63 HL Deb 27 February 2001 CWH 83
64 HL Deb 10 April 2001 c 1110
65 Under clause 31.

clause 38(1)(b) would give the CA the necessary power to raise funds for the maintenance of these units. The Earl of Caithness returned to the legitimate use of reserve funds on Report. He described the Bill's provisions in this area as "ambiguous" and wanted "no unit-holder to be under the impression that there will be a reserve fund to bail him out of his responsibilities."[66] Lord Bach agreed to reflect carefully on what the noble Earl had said[67] but this provision remains in the current Bill.

The Government rejected amendments to the first and the current Bill to require reserve funds to be held as tax exempt trust funds on the ground that CAs, unlike landlords or their agents under the leasehold system, would own and control the funds themselves:

> As I mentioned in Committee, Section 42 was introduced to improve and standardise the manner in which service charges and sinking funds are managed while they remain in the hands of the landlord. There are two benefits of the statutory trust for leasehold service charges to leaseholders. First, money paid by tenants to the landlord or his agents is safe from creditors in the event of his or their bankruptcy or liquidation. Secondly, it ensures that the landlord or his agent is subject to the duties of a trustee and will therefore be liable for breach of trust if the money is misappropriated or not adequately safeguarded or invested.
>
> Those considerations simply do not apply within commonhold. The commonhold association is a company whose members are those who pay the money into the funds. They appoint and dismiss the directors of the company. They approve the objects of expenditure and the setting of budgets and have absolute control over all aspects of the company under company law.
>
> The directors who act on their behalf are bound by their fiduciary duty to act honestly and bona fide in the interests of the company, and are to act for the proper purposes as set out in the company's constitution and in accordance with any statutory duty. They are also subject to the sanctions available both under the Companies Act and the general criminal law. They must produce accounts and answer for their contents. The funds under Clause 38 are funds of the commonhold association to be established by the directors of the association in accordance with the commonhold community statement for the purposes specified by the Bill.
>
> If a commonhold association decides, with regard to its particular circumstances and following appropriate legal advice, that it wishes to hold some or all of its funds on trust for any reason, then it may do so. We are not preventing that step being taken. However, as I explained, the purposes for which Section 42 was included in the 1987 Act simply do not apply in commonhold. It would be wholly appropriate for parts of that section to be replicated in the Commonhold and Leasehold Reform Bill.[68]

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66 HL Deb 10 April 2001 c 1121
67 *ibid*
68 HL Deb 13 November 2001 cc 479-80

There would be limitations on the use to which reserve funds could be put. It would not be possible to use these assets for the enforcement of any debt except one referable to a reserve fund activity (clause 38(4)).

Clause 39 would give a power to the court to allow a unit-holder to apply for a declaration that the CCS or M&A do not comply with the Act or regulations made under it. Time limits on action would be provided for but a court would also be able to waive these.

Clause 40 would make provision for procedures where a CA votes unanimously to bring additional land into the commonhold to be held as commonhold land.

7. Termination and insolvency

In the opinion of Professor David Clarke, termination and insolvency has been given a prominence in the Bill that is "out of all proportion to the likely need."[69] He bases this statement on evidence from Singapore and New South Wales where they are only now addressing the need for termination to permit redevelopment after decades of development of strata title blocks. He has also noted that, in contrast with previous draft commonhold Bills (1990 and 1996), this Bill has reduced the number of clauses dealing with insolvency provisions by not creating a new corporate personality. The use of a company limited by guarantee under the Companies Acts means that existing insolvency provisions can be applied. However, Professor Clarke has asked whether a winding up order should be possible when a CA can raise funds by an assessment or levy on unit-holders. He has pointed out that 40 years of experience in New South Wales would suggest that insolvency of a CA is not a problem.[70]

Clauses 42-48 deal with termination of a commonhold following from a voluntary winding up of the CA. The Explanatory Notes to the Bill suggest that this might arise where a building reaches the end of its life through old age or from an offer to buy the land by a developer.[71]

The Bill would permit termination with a unanimous resolution by CA members **(clause 43)** or, if only 80% of CA members vote in favour, the terms and conditions for a termination application would require court approval **(clause 44)**. The CA would have to appoint a liquidator[72] under both clause 43 and 44. **Clause 42** sets out the criteria that a CA must meet before a winding-up resolution could take effect. There would have to be a formal declaration of solvency by the directors, a termination statement resolution must have been passed, and each of the resolutions must have at least 80 per cent of the members of the CA voting in favour.

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69 Commonhold & Leasehold: the new law, Conference, 28 March 2001 (Jordans)

70 *ibid*

71 HL Bill 51-EN para 94

A termination application[73] would have to be accompanied by a termination statement that sets out proposals for transfer of the land and for distribution of the assets **(clause 46)**. Under **clause 47** the liquidator would have duties of notification and power to apply to the court. On termination of the commonhold the CA would take over ownership of the commonhold units **(clause 48)**.

Clauses 49 to 53 would deal with winding-up by the court following a petition to declare the CA insolvent by a creditor. Professor David Clarke described how the provisions in **clause 50** (clause 48 in the first Bill) would work:

> If provision has to be made for insolvency, the 2000 Bill seems to have an imaginative approach to balancing the possible needs of creditors of the association and unit owners. The idea is to permit winding up but provide for a 'Phoenix' association to arise from the ashes of the old. The liquidator of the old company could pursue recalcitrants and if necessary sell their units for debts owed but the other members would have protection. The ultimate sanction of winding up will be a powerful incentive for members to pay their dues and for officers for the association to be circumspect in contracts. It should avoid any risk of the CA seeking to avoid debts by not raising levies on members. It justifies the protection of reserve funds. It is to be hoped that it will make the possibility of winding up less likely but provide for the future of the commonhold should winding up occur for any reason.[74]

Clause 51 would deal with the phoenix association's assets and liabilities. **Clause 52** would make provision for the transfer of responsibilities from the insolvent association to the successor association from the time of the winding-up order.

Clause 54 would cover termination where there has been an error in registration (see clause 6) or where there is a fatal flaw in the CCS or M&A of the CA (see clause 39(3)(d)).

Protection given to reserve funds would cease once a winding-up order is made by the court or a voluntary winding-up resolution is passed **(clause 55)**.

8. Miscellaneous issues

a. Multiple site commonholds

Clause 56 would provide for the possibility of a CA being made up of two or more areas of land that need not be contiguous. The M&A would have to specify that the association is to exercise commonhold functions over the land and a single CCS would have to apply to all the land in question.

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72 Under section 91 of the *1986 Insolvency Act.*

73 Clause 45

74 Commonhold & Leasehold: the new law, Conference, 28 March 2001 (Jordans)

b. Development rights

Clauses 57 and 58 would reserve to the developer certain rights do things that would enable him both to develop and market the units in the development and develop the common parts and "react reasonably to commercial pressures."[75]

c. Compulsory purchase

Clause 59 makes special provisions for dealing with compulsory purchase of units or common parts.

d. Matrimonial rights

Clause 60 would provide that, where the term "tenant" is used in Part 1 it would apply to anyone who has matrimonial home rights under the *Family Law Act 1996.*

e. Orders and regulations

Clause 62 would provide that where the term "prescribed" is used in Part 1 it would refer to regulations to be made by the Lord Chancellor, with the exception of clause 59 (compulsory purchase). These regulations would be subject to the negative resolution procedure.

f. Jurisdiction

Clause 64(1) would provide for references to "court" in Part 1 to mean the High Court or county court.

D. Debate in the Lords

This section concentrates on those issues arising out of the commonhold proposals that have given rise to concern/discussion in responses to the draft Bill and consultation paper and also in the Lords.

1. Conversion to commonhold: consent

Clause 3 of the Bill would require that anyone with an interest in the land, including mortgagors, and anyone who has any other form of charge or caution over the land, must approve an application to convert land from freehold to commonhold. There would be circumstances (specified in regulations) in which consent may be deemed to have been given and in which a court may waive the need for consent.

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[75] HL Bill 51-EN para 111

This aspect of the Bill has led commentators to suggest that Part 1 will be unworkable because 100 per cent consent will never be achieved. The consultation paper published with the draft Bill explained the rationale behind the requirement of 100 per cent agreement:

> The Government recognises that this is a very high hurdle and that it may effectively make it impossible for the majority of long leasehold developments to convert to commonhold. However, it is of the essence of commonhold that all the unit-holders should be members of the commonhold association with the same rights and duties as between themselves and the association.
>
> Importing anomalous tenancies into a commonhold would have a number of undesirable consequences. First, as mentioned in the previous paragraph, the result would be two quite different types of tenure existing side by side, with different terms and conditions of occupation, assuming the tenants retained their leases. Second, there would need still to be a freeholder to hold the freehold of the units occupied by the tenants, and as will be seen from the next item, the commonhold association will not be permitted to own units. Third, the aim of consistency of constitution across all commonhold developments would be lost. It would be necessary to distinguish between types of commonhold to ensure that those wishing to buy into a 'hybrid' knew how far it departed from the standard.
>
> For this and other reasons it is not intended to allow conversion on other than a 100% consent basis.[76]

The Campaign for the Abolition of Residential Leasehold (CARL) described the requirement of 100 per cent consent as "an impossible feat in most blocks."[77] This sentiment was echoed in the sample of responses to the draft Bill collated by the Lord Chancellor's Department.[78]

At virtually all stages of the first and the current Bill amendments have been moved to clause 3 to remove the requirement of 100 per cent consent. The amendments have included attempts to replace this requirement with one of achieving consent amongst 80 per cent of the relevant classes of person (leaseholders)[79] or 75 per cent leaseholders and 10 per cent of tenants. Objections have also been raised against mortgagors and chargeholders being able to veto a conversion to commonhold.[80]

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76 Cm 4843 para 2.2

77 CARL's response to the draft Bill and consultation paper (Cm 4843)

78 *Commonhold and Leasehold Reform Draft Bill and Consultation Paper: responses to the consultation exercise*, Lord Chancellor's Department, January 2001, p 3 (Deposited Paper 01/192)

79 Under this amendment those leaseholders wishing to covert would have had to pay the full cost of acquiring the freehold.

80 HL Deb 20 February 2001 c CWH 5

During the Committee stage of the current Bill Baroness Scotland reiterated the Government's intention to retain the requirement of 100 per cent consent for conversion to commonhold and gave a detailed explanation of the reasoning behind this decision:

> As I am aware that I am about to disappoint a number of noble Lords, with the indulgence of the Committee I should like to explain in some detail our thinking on this matter. We believe that we may not have articulated as clearly as we might why we are so keen to implement the 100 per cent rule and neither have we exposed our rationale in sufficient detail. This is a difficult area. We have never believed that it would be impossible to devise a system to provide for the conversion of a leasehold to commonhold with fewer than 100 per cent consents of the classes that we have specified. Indeed, the Bill developed by noble Lords opposite in 1996 when they were in government proposed just such a scheme. Today, Members of the Committee have, in varying degrees of detail, suggested ways toward that end. However, our view is that, although it is perhaps possible, such a scheme would be very complex and thoroughly undesirable, and at Second Reading my noble and learned friend the Lord Chancellor signalled as much.
>
> I set out our reasoning. We recognise only too well that to obtain 100 per cent of the necessary consents will be difficult, notwithstanding that the courts will be able to dispense with consents where obtaining them proves to be impossible, for example where a leaseholder cannot be traced. That was the example we had in mind in relation to Clause 3(2)(f) to which the noble Lord, Lord Kingsland, referred. However, we believe that the difficulties which would follow from the alternative of allowing conversion with a margin of non-participants of whatever size would far outweigh any conceivable advantages, and also that, given the content of Part 2 of the Bill, it is unnecessary.
>
> Both this and previous governments have undertaken to provide for conversion from leasehold to commonhold, but the circumstances are now very different from those which obtained in 1996. Part 2 of the Bill makes available a much more straightforward way to achieve collective enfranchisement for those who are eager to own the freehold of their development than was available when the opposition's Bill was developed and conversion to commonhold was seen by many as the only viable alternative to being caught in the long leasehold trap.
>
> We have given a good deal of consideration to the process of conversion to commonhold. How will it work? We believe that the urge to convert is most likely to occur among those who have not yet taken advantage of the right to enfranchise. If it proves impossible to persuade 100 per cent of the occupants of the existing development to come on board it will be necessary for those who do consent to find the extra money needed to buy out the freeholder's interest in the non-converting units. It will then be necessary either to set up a separate company to hold the freehold of the continuing leasehold flats or, perhaps more likely, make it possible for the commonhold association to do so. The extra work and costs, including legal costs, could be considerable.
>
> Consideration would have to be given to possible amendment of the remaining leases. The memorandum and articles of association of the commonhold

association would have to be altered to take account of the ownership and management of the freehold of those units and direct relations with the leaseholders thereof. The commonhold community statement would have to take into account the distinction between commonhold units and non-consenting units and the differential management tasks. To tailor-make the documents and structures that they reflected would not only add considerably to the costs of the conversion process but fly in the face of the thinking behind commonhold, which the Committee recalls is based firmly on parity of interest and uniformity of structure and standardisation, so far as possible, of the documentation.

I was much relieved and reassured that when the noble Lord, Lord Goodhart, outlined his arguments in support of the amendment he acknowledged that problems and difficulties remained to be dealt with. It should also be noted that the original consenters will no doubt expect to recoup the extra costs arising from the conversion process and that will tend to mean either that the selling price per unit is higher than is otherwise justifiable, rendering the units relatively poor value for money, or that the extra costs just cannot be recouped in the short or even medium term.

But the difficulties that arise on conversion are just the start of the potential problems. The management of the resulting organisation, which we expect to be carried out by volunteers as the Committee will recall, will become a great deal more difficult. In addition to running the commonhold association, which despite the efforts we have made to keep it simple will still be a responsible job that requires a mix of skills, including a fair degree of diplomacy, the directors will become landlords. Their leaseholders will be the continuing leaseholders who may already be disgruntled by the conversion process in which they did not take part, for whatever reason, and through which they have been dragged against their will. They may also have had to undergo amendment to their leases or entered into disputes about the value of their remaining interest, particularly if they are not allowed to apply for lease extensions at the end of the lease period.

Inevitably, they will now be in a less favourable position than the unit-holders who are part of the commonhold in terms of both the day-to-day running of the development and the sale of the unexpired portion of their leases in due course. The full members of the commonhold may well find that their own units are worth less than those in a comparable development which does not include continuing leaseholders, and all this before the all-too-common disputes arise between landlord and tenant. Therefore, that arises even before one encounters the normal difficulties in human relationships that those of us who travel down this road know only too well. Those matters will be settled by the machinery provided for the purpose in existing leasehold law rather than the streamlined processes that we hope will apply to commonhold…

We considered fully if we could preserve the essence of what we all want from commonhold and retain that as well as having less than 80 per cent and whether there was any other way that that could be done. We reluctantly concluded that even if technically it was possible to construct something that was less than 100 per cent, it would not, because of the consequences, the complexities and the

> difficulties, be practical to do so because we would not have commonhold occurring as we all want it to; that is, with parity, equality and people working together in a scheme in which they all share an equal part.[81]

Once again on Report the Baroness defended the Government's position on the issue of 100% consent.[82]

In Committee on the current Bill Lord Best asked why the Government had not drafted Part 1 of the Bill so that commonhold would only apply to new developments given the expectation that few, if any, conversions to commonhold would take place.[83] He expressed the opinion that if the Bill results in commonhold being confined to new build properties while collective enfranchisement is available for everyone else, then the Bill will have been "grossly oversold."[84]

During discussion over other proposed amendments to clause 3 in Grand Committee on the first Bill Lord Jacobs quoted an extract from the 1998 consultation paper, *Residential Leasehold Reform in England and Wales,* in which the Government committed itself to:

> …introducing a new form of tenure for flats--commonhold--which in future will enable the individual flat-owners in a block to own and manage the whole building collectively from the outset. We see commonhold as the best way to tackle the problems faced by many existing residential leaseholders.

Lord Jacobs compared this statement with the Government's stated position in Committee, ie that it did not expect to see existing blocks of leaseholders agreeing to become part of a commonhold.[85] Lord Bach defended the Government against the charge of a change in policy direction:

> I said that we hoped that existing leaseholders might, in some cases, take advantage of commonhold. I did not pretend for a moment that it would happen in a large number of cases. I do not think that it will and the Government do not think that it will. But we do hope that it happens in some cases. I mentioned leases where there were just a couple of leaseholders. I am certainly not saying that there will be never be a case where there will be some conversion from existing leasehold to commonhold; I think that there will. That is why we will be trying to persuade leaseholders or talking to leaseholders about changing to commonhold. But we are realistic about it. We know that it cannot be done overnight.[86]

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81 HL Deb 16 October 2001 cc 488-90
82 HL Deb 13 November 2001 cc 467-8
83 HL Deb 16 October 2001 c 496
84 *ibid*
85 HL Deb 20 February 2001 CWH 31
86 HL Deb 20 February 2001 CWH 33

2. Commonhold on new developments

The Government made it clear during the debate in Grand Committee on the first Bill that it expected the majority of commonhold developments to be formed by new developers "starting from scratch." The question of *ensuring* that all new developments of multiple residential accommodation would be organised on a commonhold basis was raised in Grand Committee by Baroness Gardener of Parkes. She moved an amendment that would have inserted a new clause into the first Bill to require local authorities to refuse planning permission for such developments unless the land in question had been or would be registered as a freehold estate in commonhold.[87] The Baroness argued that commonhold would not "get off the ground" unless there was an element of compulsion for at least a limited period of time.[88] She drew comparisons with Australia where commonhold units[89] attract a higher price and argued that once commonhold was established no-one would consider building anything else.

Lord Goodhart moved an amendment to the first Bill that would not have prevented the development of new leasehold properties but would have specified a minimum term of 150 years for leases granted at a premium in order to "defer the problem for a long time."[90]

Lord Bach said the Government had no intention of cutting off the possibility of leasehold development but agreed to look at ways in which commonhold could be marketed.[91] He identified problems with Lord Goodhart's amendment:

> In many cases, developers may be able to acquire land only on a leasehold basis. They will be unable to offer leases for a longer term than the term granted to them. Land subject to a lease of less than 150 years could not be utilised for residential development unless the developer could persuade the landowner to grant a new lease of an appropriate term. That may distort the market and prevent the sensible use of land. There may be difficulties in redeveloping existing leasehold property which has reached the end of its life if those concerned are unable to acquire the freehold or to do so on reasonable terms. In addition, council tenants have the right to buy a long lease on the flat in which they live. Local authorities may hold the land on which the flats are built only on leasehold.
>
> The amendment, if carried out to the letter, would remove consumer choice in prohibiting the grant of any lease below 150 years for a premium. We are advised that it would, therefore, apply to an assured shorthold tenancy where the rent was payable as a lump sum in advance. Where willing parties wish to agree to such an arrangement, such as a company requiring temporary accommodation for an

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87 HL Deb 20 February 2001 CWH 26
88 *ibid*
89 Referred to as strata title in Australia.
90 HL Deb 20 February 2001 CWH 27
91 HL Deb 20 February 2001 CWH 30

> employee, it would be wrong to interfere. The amendment does not deal with the fundamental problem, as the noble Lord sees it, of leasehold tenure. It would not prevent leasehold abuse nor prevent the lease depreciating over time, albeit a long period of time. It would probably merely postpone the latter problem. However, the noble Lord raises a serious issue and we shall look at it again.[92]

At Report and Third Reading Lords Goodhart and Jacobs moved amendments that would have meant that the minimum term of a lease that a landlord could grant at a premium would be 300 years:

> The principle that the landlords wish to establish is that of a second bite of the cherry. That is to enable the tenant or his successors who believe they purchased their own home to purchase again in 75 or 99 years and then at a greater market value. That is a "nice little earner", as they say. This amendment is designed to extinguish the landlord's interest and enthusiasm for achieving successive bites of the cherry. Perhaps the amendment would be better if it were for 999 years, but I still believe that 300 years is sufficient. I am sure that the Government recognise that the landlord is not being deprived of any element of value when he grants a lease for 300 years.[93]

Lord McIntosh gave the Government's reasons for rejecting the amendment. He was concerned that any restriction on the granting of leases would limit the choice of the purchaser. He also pointed out that there would be circumstances in which a developer or landlord would only hold a leasehold interest and would not be able to grant a lease beyond the term of their own interest.[94] He advised that the Government would monitor the development of commonhold after the enactment of the Bill and that they would be prepared to consider restrictions on use of leasehold tenure if there was a clear need to do so. It is expected that leasehold tenure will "gradually wither on the vine" as commonhold becomes the preferred form of tenure.[95]

During the Report stage of the first Bill Baroness Gardener of Parkes moved an amendment to insert a new clause that would have required the Lord Chancellor to report to Parliament within two years of the commencement of Part 1 on the number of commonhold registrations that had taken place, together with a commentary on the market response to Part 1. The amendment would have required the Lord Chancellor to express an opinion on whether the take-up of commonhold had been satisfactory and, if it had not been, to lay regulations to require all new developments of blocks of flats to be registered as freehold estates in commonhold land. She described the whole process of commonhold in the Bill as "completely negative."[96] Responding, Lord Bach said that the

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92 HL Deb 20 February 2001 CWH 31
93 HL Deb 19 November 2001 c 933
94 HL Deb 19 November 2001 cc 935-6
95 HL Deb 13 November 2001 c 549
96 HL Deb 10 April 2001 cc 1131-2

question of accelerating the end of leasehold would be kept under review but rejected the method and timescale proposed in the Baroness's amendment.[97]

3. The Commonhold Association and company law

Leaseholder groups believe that company law is too complex for flat management and that a distinct form of corporate entity should be developed for this purpose.[98] The Law Society's response to the draft Bill suggested that reservations about company law, which centre around the need to make returns to Companies House and the limitation of liability, could be addressed by modifying the rules applicable to companies used as commonhold associations.[99]

Professor David Clarke has commented:

> By utilising the company limited by guarantee, it becomes unnecessary to make special insolvency and other provisions for a new corporate vehicle. But the solving of the insolvency 'cuckoo' comes at a price. There is the risk of the CA failing to file returns and getting struck off. Many of the rules and regulations relating to meetings and directors seem over prescriptive for a commonhold situation and may well be used by an awkward member to harass well-meaning lay directors of a company – as already happens.[100]

In Grand Committee on the first Bill Lord Kingsland said:

> Some commonhold associations will cover a very small number of unit-holders, where the management problems they face are relatively straightforward. Is it right that they should be faced with the full panoply of the Companies Acts as a framework within which to pursue their management responsibilities? I would go further than that. If the Government insist on using the Companies Acts as the basic framework for the management of a commonhold association, would it not be better to adopt the model of a company limited by shares rather than a company limited by guarantee?
>
> I can see in that situation at least two advantages that would accrue to the commonhold association. First, the association would be able to differentiate between unit-holders who had different degrees of interest in the association, perhaps by having some shares as category A shares and other shares as category B shares.
>
> Secondly, it would provide a simple solution to the problem that I raised when we discussed the first set of amendments; that is, the problem of requiring individual

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97 HL Deb 10 April 2001 c 1133

98 *Commonhold and Leasehold Reform Draft Bill and Consultation Paper: responses to the consultation exercise*, Lord Chancellor's Department, January 2001, p 7 (Deposited Paper 01/192)

99 Law Society's response to the draft Bill and consultation paper, para 24

100 Commonhold & Leasehold: the new law, Conference, 28 March 2001 (Jordans)

> unit-holders to meet their obligations with respect to the common property. A simple provision which prevented the transfer of a share from vendor to purchaser until the vendor had met all his obligations could achieve the same result as a forfeiture provision, or a provision similar to forfeiture of the kind I sought to describe in my earlier amendment. I beg to move.[101]

Lord Kingsland returned to this issue at the Report stage of the first Bill and moved the same amendments.[102] Other Peers, while agreeing that a company limited by guarantee was not a suitable structure for a CA, rejected the suggestion of a company limited by shares "since the whole nature of a commonhold association is that it should be on a one member one vote basis."[103] Baroness Gardner of Parkes drew comparisons with the position in Australia:

> **Baroness Gardner of Parkes:** My main experience is as a unit-holder and, therefore, I cannot say that I have ever been much involved in the direct management of the company. However, I phoned Australia a week or so ago to ask about that and to ask, in particular, whether the full obligations of company law came with being the owner of the unit. I was told, no; it came within a slightly different company law. It came under a specific category but you filed your returns and annual accounts in the usual way. I wonder, therefore, whether the Minister could find out more from New South Wales about exactly how this ties in with normal commercial law or company law.[104]

Responding, Lord Bach said that he would consider the suggestion of a limited liability partnership but was inclined to think that a company limited by guarantee was a simple and fairly well understood structure. He said "we would need some persuading before we changed from such a company limited by guarantee."[105]

During the Committee stage of the current Bill Lord Goodhart moved an amendment that would have enabled the use of the limited liability partnership structure instead of a company limited by guarantee for CAs, Right to Manage Companies and Right to Enfranchise Companies.[106] Lord McIntosh of Haringey responded for the Government:

> It is probably easier if I talk simply in terms of the commonhold association, although the arguments apply to all three vehicles. I am glad that the Committee has had the opportunity to look at this again. There remains an element of unknown quantity about limited liability partnerships. Although 850 are registered, they have hardly started work. The main catalyst for the 2000 Act was concern expressed by professional partnerships about the increasingly high levels

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[101] HL Deb 27 February 2001 CWH 68
[102] HL Deb 10 April 2001 c 1106
[103] *ibid*
[104] HL Deb 27 February 2001 CWH 70
[105] HL Deb 27 February 2001 CWH 73
[106] HL 16 October 2001 c 526

of damages awarded against them in professional negligence actions. However, they are not moving from a company limited by guarantee but from a partnership of the more traditional form. Clearly, the conceptual foundations of the 2000 Act do not apply to commonhold associations.

Section 2(1)(a) of the Limited Liability Partnerships Act 2000 provides that in order to establish a company as a limited liability partnership, it must be a lawful business carried out with a view to profit. As the Bill proceeded I explained that there was no intention in the genesis and evolution of limited liability partnerships that they should be used by organisations not operating with a view to profit. That is really the nub of the issue as far as we are concerned. A commonhold association may make a profit, but that is not the object of the company; the object is to carry out the functions of a commonhold association in relation to the body named in the memorandum and articles of association.

In residential commonhold, the commonhold association's main concern will be to facilitate the growth and development of a thriving community of unit-holders and to enable them to play an active role in determining the future of that community. We can make similar points about the right-to-manage and right-to-enfranchise companies. That is the fundamental difference and why we would oppose the limited liability partnership route.

So far as concerns Amendment No. 44 tabled by the noble Lord, Lord Kingsland, we cannot accept the idea of a commonhold association having objects other than those specified in the Bill and memorandum and articles. The objects stated in the memorandum and articles give a fuller exposition of the object of the commonhold association in Clause 33 of the Bill.

The noble Lord, Lord Goodhart, may argue that Section 2(1)(a) of the 2000 Act could be disapplied in order to establish any or each of our three companies as limited liability partnerships. However, that is a fundamental clause in the Limited Liability Partnerships Act. It appears second in order only to a provision establishing that a new form of body corporate called the limited liability partnership is to be made available and as such is prescriptive of one of the keystones of the limited liability partnership. Therefore, I must respond to the noble Lord by asking a question: why use the limited liability partnership format for a commonhold association if it will be necessary to tamper with one of the underlying premises on which it is based? It seems slightly perverse to choose as the format for a commonhold association a corporate body that will require fairly extensive surgery on its conceptual basis in order to integrate with commonhold.

We have previously debated these issues. Therefore, on the basis of the updated and revised--in the light of experience--responses which I am now able to give I hope that the noble Lord, Lord Goodhart, will not pursue his amendments. [107]

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[107] HL Deb 16 October 2001 cc 527-8

4. Restrictions on leasing

The consultation paper that accompanied the draft Bill[108] proposed that the letting of commonhold units would be restricted to short term lets to avoid the development turning into a long leasehold development. There was some support amongst respondents for this: suggested maximum letting periods ranged from two to seven years. It was suggested that the CCS should insist upon any letting agreement including "all relevant provisions and requirements as if the tenant were the unit holder."

On the other hand, some respondents cautioned against restricting the power of a unit-holder to grant leases out of residential commonhold on the grounds that this would interfere with an owner's freedom to deal with his or her own property and could have a deleterious effect on the marketability of residential commonholds.[109]

Clause 17(1) of the Bill would allow for the making of regulations that would place restrictions on the ability of a unit-holder to treat his or her unit as though it were a freehold unit. The intention, according to the Explanatory Notes on the Bill, is that regulations would prohibit the payment of a premium for a lease and would limit the period of a single term lease to seven years.[110] This change in approach came about largely in response to those respondents who lobbied the Government about the significant percentage of flats that are bought to let.[111]

At the Committee and Report stages of the current Bill Lord Goodhart moved an amendment to have the provisions that would be included in regulations placed on the face of the Bill in order to provide certainty.[112] During progress on the first Bill Baroness Gardener of Parkes moved an amendment to delete clause 17 altogether:

> There should be no restrictions whatever. Once you own your unit of commonhold, it should be entirely up to you what you do with it. If you want to let it for ever, that is up to you; if you want to let it for a short time or a long time, that is also up to you. I do not know where the provision comes in about seven years and the liability for repairs. It is not something I have ever thought about. I am not familiar with it and I do not understand it. I have known of people owning units and living abroad for 20 years. That does not apply to me--I have lived abroad for 40 or 50 years. The whole essence of commonhold is for it to be free. The noble Minister told us just a moment ago that he did not want that last restriction about transferring title, nor any restriction on commonhold. He referred to the value of the freedom of commonhold; that it is yours, to do with as

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[108] Cm 4843

[109] *Commonhold and Leasehold Reform Draft Bill and Consultation Paper: responses to the consultation exercise*, Lord Chancellor's Department, January 2001, pp 21-24 (Deposited Paper 01/192)

[110] HL Bill 51-EN para 65

[111] *Commonhold and Leasehold Reform Draft Bill and Consultation Paper: responses to the consultation exercise*, Lord Chancellor's Department, January 2001, p 34 (Deposited Paper 01/192)

[112] HL Deb 16 October 2001 cc 513-4; HL Deb 13 November 2001 c 475

> you wish. Then we come to this clause and see that we are going to restrict what you can do with it, in terms of having a tenant or anyone else.
>
> **Lord Goodhart:** I am grateful to the noble Baroness for giving way. However, would she allow a unit holder to grant a 99-year lease at a premium?
>
> **Baroness Gardner of Parkes:** I probably would, but I doubt whether anyone would want to do that. It would seem most extraordinary for anyone to have such an aim. However, if you own a unit, it is entirely up to you what you do with it. That is how the Australian system works and it is the right way. There should be no unnecessary restrictions. In response to the previous amendment, the Government said that they did not wish to impose that degree of restriction with regard to people settling their debts. So why should they wish to make this one?

During the Report stage of the current Bill Baroness Scotland defended clause 17 thus:

> We shall be putting the limits for residential leasing in the commonhold community statement and they will be mandatory. But the seven-year maximum lease period was not chosen at random either. As your Lordships know, it was chosen because it is the time limit at which responsibility for repair and insurance to the property passes from the landlord to the tenant. But if, in the future, the market dictates that a different period of maximum lease length would be advantageous, we would want the flexibility to be able to react to that. It would be wrong unduly to tie our hands and make us reliant on finding parliamentary time to amend such things in primary legislation when regulations could be introduced speedily and easily.
>
> The noble Lord, Lord Kingsland, would omit from the Bill any power to regulate the letting of residential leases. We regret to say that we cannot agree with him. Although we have tried to avoid the setting of too many regulations about commonhold, we are convinced that we should avoid the possibility that commonhold units be turned into just so many more long leasehold properties.
>
> Much has been said during our debates on this Bill in your Lordships' House and elsewhere that the Government should have gone further than we have and forbid the development of new leasehold properties; and even to convert all current leaseholds into commonholds. Although, for the reasons we have given, we are not prepared to go that far, we certainly take the view that we should avoid the introduction of the long leaseholder traps into commonhold. That is what Clause 17 sets out to do. Without it, we would be powerless to do so.[113]

[113] HL Deb 13 November 2001 c 477

5. Dispute resolution

This is an area where some commentators believe that Part 1 of the Bill is defective. **Clause 34** of the Bill sets out the Commonhold Association's "duty to manage"; clause 34(3)(b) would provide that the association:

> Shall have regard to the desirability of using arbitration, mediation or conciliation procedures (including referral under a scheme approved under section 41) instead of legal proceedings wherever possible.

Professor David Clarke described clause 34(3)(b) of the first Bill (the original draft of the Bill did not contain reference to an ombudsman scheme) as "lame" and expressed the belief that eventually Leasehold Valuation Tribunals would have to act as "Commonhold Conciliation Committees" and provide the same service for commonhold unit-holders that they do for leaseholders.[114] There is certainly concern amongst commentators over the absence of any intention to develop a separate dispute resolution procedure for commonhold. This can be contrasted with the Australian system where there is a Strata Title Commissioner.

Clause 41 would give the Lord Chancellor power to approve an ombudsman scheme or schemes as part of the dispute resolution process available to CAs and unit-holders. Lord Kingsland questioned relevance of ombudsman schemes during the Committee stage of the current Bill:

> If disputes are to be determined in accordance with legal principles, the court or an arbitrator is the appropriate forum and there is no need for an ombudsman. If ADR mediation, or something similar is required, a voluntary ADR scheme would be sufficient. Commonhold associations could even choose to include references to such a scheme in the commonhold community statement.
> If the ombudsman will not apply strict legal principles, it is a breach of the rights of the commonhold association--and potentially unfairly prejudicial to the rights of all the other unit-holders not involved in the dispute--for, first, a reference to the ombudsman to be compulsory and, secondly, for the ombudsman's decision to be binding on the commonhold association--particularly if the unit-holder involved in the dispute is not bound by the decision. It is a possible human rights breach for a unit-holder potentially to be jointly liable on such a judgement debt when the unit was not a party to the proceedings in which the judgement arose.[115]

Responding, Baroness Scotland defended the use of an ombudsman scheme:

> Finally, the noble Lord expressed some doubts about the ombudsman clause. I noted the hesitance and reluctance with which he ventured those comments. I share the wisdom of that hesitance. Clause 41 introduces an ombudsman scheme

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[114] Commonhold & Leasehold: the new law, Conference, 28 March 2001 (Jordans)
[115] HL Deb 16 October 2001 c 507

> into the Bill. Your Lordships may well be aware that the Government take the view that it should be closely modelled on the independent housing ombudsman scheme. We believe that there is real merit in keeping disputes arising in commonholds away from the courts and tribunals insofar as it is proper to do so, always with the proviso that the courts will be there in the last resort. Clause 34(3)(b) requires the directors of the commonhold association to consider alternative dispute resolution before resorting to the courts. The independent housing ombudsman scheme is inexpensive, quick and flexible and has a good reputation. An ombudsman scheme seems to us to be a perfectly good model to adopt as one approach to dispute resolution.[116]

Lord Goodhart moved an amendment in Committee to try and include in the Bill something akin to forfeiture provisions to be used in the event of a unit-holder failing to abide by certain conditions.[117] He thought that, without the threat of forfeiture or its equivalent, it would be far more difficult to enforce timely payment of contributions to the CA. Baroness Scotland replied: "we remain firmly of the opinion that forfeiture, or any similar provision by whatever name, is quite inappropriate for commonhold."[118] Enlarging on the topic, she said:

> A commonhold unit is a freehold estate in commonhold land. Forfeiture is a process used by the holder of a superior interest to prematurely terminate an inferior interest in his property. Termination of the interest by the holder of the superior interest occurs because of the failure of the holder of the inferior interest to fulfil an obligation owed to the holder of the superior interest. Such a relationship simply does not exist, and is not intended to exist, within commonhold. We are talking about unit holders who have a parity of position without superiority or inferiority. There is no one with an interest in a commonhold unit superior to that of the unit holder. The commonhold association is the registered proprietor of the freehold estate in the common parts but has no claim to the units, nor should it, we believe.
>
> Apart from the innate unsuitability of forfeiture as a vehicle for debt recovery in commonholds, we have stressed previously--I repeat this today--that forfeiture is widely abused and hated in the leasehold context. I do not think that that is putting it too high. In recognition of the problems with forfeiture, provisions in Part 2 of the Bill will curb the ability of landlords to serve forfeiture notices without a determination by a leasehold valuation tribunal or LVT. I am sure that the Committee does not want to import into commonhold a process that has been widely condemned in its application to leasehold tenure and which we are currently seeking to rein in.[119]

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[116] HL Deb 16 October 2001 c 512
[117] HL Deb 16 October 2001 cc 505-6
[118] HL Deb 16 October 2001 c 508
[119] HL Deb 16 October 2001 c 509

Paragraph 9 of schedule 5 to the Bill would extend the scope of the Leasehold Advisory Service (LEASE) to cover advice on the law relating to commonhold land. LEASE was created in January 1994 under section 94 of the *1996 Housing Act* to provide advice on enfranchisement issues and aspects of the law of landlord and tenant as it relates to residential tenancies. This provision has been welcomed.

6. Delegated powers

As noted earlier in this paper, Part 1 of the Bill would establish the framework within which commonhold schemes will be developed; the details will be fleshed out in regulations. The delegated powers in the first Bill were considered by the Select Committee on Delegated Powers and Deregulation in its 5th Report of 2000/01.[120]

The Lord Chancellor's Department and the Department of Environment, Transport and the Regions (now the Department of Transport, Local Government and the Regions) supplied a memorandum to the Committee that gave an overview of the delegated powers in Part 1:

> **Simplicity**
> 13. Commonhold is a new and untested land tenure in England and Wales. For many who want to explore alternatives to leasehold and freehold the Bill will be an introduction to commonhold. It is therefore appropriate to strive for simplicity and brevity on the face of the Bill to ensure comprehension, workability, and the familiarisation of those who may potentially have an interest, with the terms and key concepts of commonhold. Given this aim, the policy behind the content of the Bill is that it should simply set out the framework for the establishment and management of commonhold. Comprehensive coverage of the more complex and less fundamental areas will be contained in delegated legislation.
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> 14. It is intended that much of commonhold will be based, as far as is reasonably practicable, upon relevant existing legislation rather than creating a scheme based entirely on new concepts. So, for example, the commonhold association will be a company limited by guarantee under the Companies Act 1985, subject to necessary deviations. In practical terms, this will cut down on unnecessary complexity within the Bill and will ensure that professionals will be ready to give advice on commonhold within a fairly short time of introduction. It is felt that the use of existing legislation means that it is more appropriate for commonhold legislation to be placed in delegated legislation rather than appearing on the face of the Bill. This will ensure speed and simplicity of amendment, if any of the Acts or precepts upon which Part I of the Bill is based, are amended or superseded.

[120] HL Paper 21 2000-01

Flexibility

15. Although commonhold is successfully used in other jurisdictions, it is possible that practical problems will arise when commonhold is first introduced to the property market place in England and Wales. In the interest of the successful adoption of commonhold it ought to be possible to respond rapidly to any such difficulties. To realise the flexibility to react efficiently with rectifying or ameliorating provisions, it is thought best for much of the regulatory regime applicable to commonhold to be contained in delegated legislation. This will allow future needs and developments to be taken into account without having to revert back to Parliament for primary legislation.

16. Consultation responses based on the experiences of other jurisdictions, particularly the United States, suggest that secondary legislation is the correct vehicle through which to address the majority of the rules and regulations. As the American experience demonstrates, dealing with the detail of commonhold through primary legislation does not provide the flexibility required, when legislating on tenure that potentially encompasses such a wide variety of schemes.

17. Experience with existing leasehold legislation has shown that flexibility is sometimes desirable to deal quickly and effectively with practical problems which emerge with the legislation. It can be the case that primary legislation fails to deal adequately with new practices that emerge or with unusual or unforeseen circumstances. For this reason, it is felt that certain matters of detail should be either prescribed in or capable of amendment by secondary legislation. Without such flexibility, it may not be possible to provide the desired protection for leaseholders until such a time as further primary legislation can be enacted. This is particularly the case for certain aspects of the right to manage, such as the definition of 'management functions' and the constitution of the company, where any deficiencies which arise could have the practical effect of preventing the right operating properly.

Parliamentary Scrutiny

18. Subsection 61(2)(e) provides that all regulations under Part I shall be subject to annulment in pursuance of a resolution of either House of Parliament. The negative resolution procedure has been chosen for the commonhold delegated legislation following consideration of the recommendations in the first report of the Select Committee on the Scrutiny of Delegated Powers. We have paid particular attention to the 1973 Brooke Committee Report criteria for selection of forms of Parliamentary control and we do not believe the affirmative procedure is necessary for any of the regulations under Part I of the Commonhold and Leasehold Reform Bill.[121]

[121] HL Paper 21 2000-01 Annex 2

The Committee concluded that the conditions regulating leasing (of commonhold units)[122] needed to be known and recommended that draft regulations be published during the passage of the Bill or that the conditions should be set out on the face of the Bill.

In regard to clause 31[123] and paragraph 2 of schedule 3,[124] the Committee concluded that the House may wish to see a draft of at least the principal elements of the regulations before reaching a decision on their merits or, failing that, that the House "may think it appropriate that the first set of regulations (in each case) should require affirmative procedure."[125]

The Select Committee identified several clauses in Part 1 containing "Henry VIII powers" but concluded that in each case there was no need to challenge the use of the negative procedure.[126]

The Government accepted the Select Committee's recommendations and the Committee declared itself to be "satisfied with this response."[127]

At various points in Grand Committee and on Report on the first Bill Peers referred to the question of whether regulations should be made subject to the affirmative or negative resolution procedure. Amendments moved to clause 33 (Constitution) sought to have the CCS and M&A put on the face of the Bill (as a schedule) or to have the regulation making powers under which they would be made, made subject to the affirmative resolution procedure.[128] Lord Bach, responding, indicated that the CCS and M&A were such important documents that the Government was minded to agree that they should come back to the House once finalised and be subject to the affirmative resolution procedure.[129]

II Part 2: Leasehold reform

A. Leasehold management: the problems

Long leaseholders in blocks of flats buy the right to live in their property but the management of the block, including its maintenance and insurance, normally remains in the hands of the freeholder. The lease agreement usually makes provision for the costs of the freeholder or his/her agent in discharging these management functions to be met in full by the leaseholders; these payments are referred to as service charges. Despite

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[122] Clause 17
[123] Which would require regulations to be made prescribing the content of a CCS.
[124] Which would require regulations to be made as to the form and content of the M&A of a CA.
[125] HL Paper 21 2000-01 para 31
[126] *ibid* paras 25-29
[127] HL Paper 35 2000-01 para 12
[128] HL Deb 10 April 2001 c 1106
[129] HL Deb 27 February 2001 CWH 75

previous attempts to strengthen the rights of leaseholders to challenge poor management by freeholders,[130] the Government believes:

> that the landlord's monopoly over the supply of the services in the property is not justified. In most cases the financial value of the landlord's interest in the building is very small in comparison with that of leaseholders.[131]

The Explanatory Notes to the Bill state that the protection afforded by the law "remains incomplete and the remedies available to leaseholders are considered to be difficult and costly to use."[132] The *Draft Commonhold and Leasehold Reform Bill* (with attached consultation paper) of August 2000 described proposals that are intended to:

> redress the uneven balance between landlords and leaseholders, and give leaseholders a greater degree of control over the management of their homes which reflects the substantial investment they have made. They are also intended to prevent unreasonable or oppressive behaviour by unscrupulous landlords, and would provide flexibility to tackle any new forms of abuse that may arise in the future.[133]

B. The right to manage (clauses 69-111)

1. The nature of the right to manage

Under existing provisions[134] leaseholders of most privately owned flats may apply to a leasehold valuation tribunal (LVT) for the appointment of a new manager. [135] In order to be successful the leaseholder(s) must be able to demonstrate serious abuse by the ground landlord.

Clauses 69-111 of the Bill would introduce a "no fault right to manage"; leaseholders in a block would have a collective right to take over the day-to-day control of their blocks without having to prove any shortcomings on the part of the ground landlord. No compensation would be payable to the ground landlord. The aim of the right to manage is to provide an alternative option to leasehold enfranchisement for leaseholders who are unhappy with the management of their blocks but who cannot for some reason, eg cost, buy the freehold.

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130 *1985 Landlord and Tenant Act*; *1987 Landlord and Tenant Act*; *1993 Leasehold Reform, Housing and Urban Development Act; 1996 Housing Act*

131 Cm 4843, p 115

132 HL Bill 51-EN para 24

133 Cm 4843, p 107

134 *1987 Landlord and Tenant Act*

135 This procedure is not available to leaseholders of the Crown, a local authority or other public sector landlord or a registered social landlord or where the landlord is resident and it is a converted block.

Eligible leaseholders will be required to set up a qualifying company, known as a right to manage (RTM) company in order to exercise the right to manage.

In response to the 1998 consultation paper on leasehold reform[136] the Coalition Against Residential Leasehold (CARL) described the "no-fault right to manage" as something that "leaseholders have been striving to achieve for many years."[137]

From the "landlord" point of view, the British Property Federation's (BPF) response to the *Draft Commonhold and Leasehold Reform Bill*[138] acknowledged the Government's commitment to the introduction of the right to manage but expressed "serious reservations regarding the practicality of what is proposed."[139] Both the BPF and the Chartered Institute of Housing (CIH) stressed that those exercising the right to mange must be made fully aware of what they are taking on. The BPF does not want to see a short-term approach to block management where minimising service charges is prioritised over proper upkeep and maintenance.

The success of the right to manage would seem to depend on how preferable it will be to leaseholders compared with enfranchisement. If the cost of enfranchisement is prohibitive for leaseholders then self-management will give them some control over their buildings as long as all of the tenants are prepared to work co-operatively.

2. Qualifying rules

a. Premises

Clause 70 would provide for the RTM to be exercised by leaseholders of any detached property or self-contained part of a property containing two or more flats held by qualifying tenants. Qualifying tenants would essentially be leaseholders with leases that were originally granted for a term exceeding 21 years **(clauses 74 and 75** define a long lease). There would be only one qualifying tenant per flat and tenants with business or commercial leases would not qualify **(clause 73)**.

Qualifying leaseholders would be required to hold not less than two-thirds of the flats in the property and the participating leaseholders (ie those leaseholders that became members of the company) would have to hold the leases of at least half of the flats in the block. [140]

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136 DETR, *Residential Leasehold Reform in England and Wales*

137 CARL's response to *Residential Leasehold Reform in England and Wales*, March 1999, p 13

138 Cm 4843, August 2000

139 BPF's response to the draft Bill, para 53

140 These criteria mirror those currently used for the right of collective enfranchisement under the *1993 Leasehold Reform, Housing and Urban Development Act.*

Certain premises, such as those owned by a local housing authority, would be excluded,[141] although properties owned by registered social landlords would be included. The Government has argued that local authority tenants already have a separate right to manage (which encompasses all tenants, including long leaseholders) and therefore it sees no justification for granting an overlapping right which applies only to long leaseholders in such properties. Charitable housing trusts will not be excluded from the right to manage although they are excluded from the right to enfranchise.[142]

Other excluded premises would include:

- premises in mixed residential and non-residential use where the internal floor area of the non-residential parts exceeds 25% of the total internal floor area of the property. (This would apply, for example, to buildings where there are flats above a shop. In such a case, it would not be possible to exercise the RTM if the shop forms more than a quarter of the building). This mirrors the proposals for collective enfranchisement (in Chapter 2 of the Bill);

- premises which have been converted into flats (or a mixture of flats and other units used as dwellings, eg bedsits), if the converted building contains no more than four units and the landlord (or an adult member of his family) lives in one of those units and has done so for the previous 12 months;

- premises where a RTM company is exercising the right to manage or where the right has been exercised but ceased to be exercisable within the last four years. On application a leasehold valuation tribunal would be able to waive the second limitation if it thinks it unreasonable in the circumstances.

- premises where different persons own the freehold of different parts of the building where any part of the premises is self-contained.[143]

In Grand Committee on the first Bill amendments were moved to clause 69 (now **clause 70**) to extend the RTM to cover estates of buildings including those covered by Estate Management Schemes.[144] Lord Lea of Crondall summed up the problem:

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141 Schedule 6 would set out the excluded premises.

142 HL Deb 1 March 2001 CWH 144

143 This provision (paragraph 2 of schedule 6) mirrors provisions in the 1993 Act (as amended by the 1996 Act) to prevent landlords from dividing the freehold of a block into parcels to make it impossible to enfranchise. The RTM would be exercisable on each self-contained part and, if not self-contained, the RTM would be exercisable across the whole building.

144 An estate management scheme is a scheme approved by a leasehold valuation tribunal for an area occupied directly or indirectly under leases held under one landlord. The purpose of these schemes is to prevent wholesale enfranchisement from damaging or destroying the character of estates held by one landlord.

> Within the present definition, where RTM is contemplated for an estate comprising, say, six separate blocks of flats, each building must satisfy eligibility and make an application separately. This is unnecessarily bureaucratic, more expensive in legal costs and could cause problems in the management of common areas in estate-wide contracts if only one or two of the blocks proceed.[145]

The then Parliamentary Under-Secretary of State at the DETR,[146] Lord Whitty, expressed "some sympathy" with the concerns raised but owing to the complexities involved, such as the difficulty of defining an "estate," he preferred that the matter be left for a later Bill.[147] Baroness Gardner of Parkes raised the matter again during the Committee stage of the current Bill. Lord Falconer advised that the Government was "reflecting on the correct approach." He could not guarantee that the Bill would be amended to cover this issue.[148]

An issue that was widely discussed during the consultation process was the application of the RTM in mixed-use (business and residential) premises. The Royal Institute of Chartered Surveyors (RICS) said it would like to see the RTM restricted to residential only areas in mixed-use buildings.[149] The Leasehold Advisory Service said it did not believe that landlords or tenants would welcome the transfer of management of commercial elements.[150]

During the Committee and Report stages of the current Bill Lord Kingsland moved amendments to exclude mixed residential and commercial premises from the RTM altogether. On Report he said:

> The problem with which the amendment is concerned is that of mixed developments where there are shops or offices on the ground floor with residential premises upstairs. I believe that there is general agreement that it is inappropriate for residents to have management of the commercial premises. Indeed, the noble and learned Lord said at Committee stage,
>
> "I stress that under the Bill there would be no question of the RTM company becoming involved in the commercial relationship between the landlord and his business tenants".--[Official Report, 16/10/01; col. 540.]
>
> I respectfully agree. A commercial tenant expects a professional landlord, not an RTM company run by residents. The difficulty is that the Bill, as framed, necessarily involves the RTM company making decisions which impact on the relationship between the landlord and the commercial tenants. Just about every major decision on the maintenance of the building, for example, will be a decision for the RTM company, not for the landlord.

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145 HL Deb 27 February 2001 CWH 99
146 Now the Department for Transport, Local Government and the Regions (DTLR).
147 HL Deb 27 February 2001 CWH 101
148 HL Deb 16 October c 541
149 RICS' response to the draft Bill, p 10
150 Leasehold Advisory Service's response to the draft Bill, para 1.2

> As I understand it, the Government place great reliance on Clause 94(6)(a) to achieve their aim of separating out the commercial part of the premises. But I suggest that this clause will result in enormous demarcation disputes. When this matter was in Committee, I gave the example of approving the frontage of a shop and decisions on the hanging of signs outside. I asked whether matters of that sort would be for the RTM company or for the landlord. I listened in vain for any answer from the noble and learned Lord as to which side of the line such an issue would fall.
>
> A particular problem to which the noble and learned Lord has drawn our attention, as did the noble Lord, Lord Whitty, when the matter was before your Lordships House prior to the election, was the risk of landlords changing the use of a small part of a block into commercial premises with the aim of escaping the right to manage legislation. Indeed, the noble Lord, Lord Whitty, was particularly concerned about that risk. He said that a broom cupboard suddenly becomes an office and an attic becomes a factory.
>
> The noble and learned Lord, Lord Falconer, when the matter was in Committee this time, was perhaps more sanguine. He merely pointed to the dangers of a block being 99 per cent residential and one per cent commercial. In my submission the answer to these points is two-fold. First, the amendment I propose limits the exemption of commercial premises to those where planning permission has been granted or where there is an established user certificate. That avoids the concern of the noble Lord, Lord Whitty, to preserve broom cupboards as storage areas for brooms.
>
> Secondly, the number of blocks where the commercial element is one per cent must be minuscule. Accurate statistics are somewhat hard to come by, but the number of properties which are excluded from the right to manage by the 25 per cent commercial hurdle is estimated to be about 10 per cent of all residential blocks. Excluding all these blocks is thus unlikely to be a practical problem.
> We on this side of the House would like to see a workable solution to the problem of mixed developments, which have a vital role to play in urban regeneration. We need to encourage traditional corner shops. Yet if developers know that they run the risk of almost immediately having the right to manage taken away from the landlords, they will shy away from building developments with flats over shops. Until a workable solution has been found, surely the safest course is to exclude mixed premises from the right to manage. I beg to move.[151]

Lord Falconer, for the Government, rejected the amendment:

> As made clear by my noble friend Lord Whitty, and by myself in Committee, we have two reasons for being firmly opposed to this amendment. First, we consider it to be wrong as a matter of principle. The right to manage is designed to allow

[151] HL Deb 13 November 2001 cc 481-82

> leaseholders who hold a majority of the equity in their block to take over the management of that block.
>
> As explained previously, the 25 per cent threshold set by Schedule 6 paragraph 1 reflects that. Amendment No. 22 does not. It would allow the landlord to retain a monopoly over the management of the block even where a commercial unit accounts for no more than one per cent of the overall floor space. We consider that wrong and wholly contrary to the spirit of the right to manage. That point has nothing to do with the potential for either confusion as to where the line is to be drawn or abuse; it is simply concerned with the principle that the right to manage should be designed to allow leaseholders who hold the majority of the equity in their block to take over its management. That is what the principle reflects.
>
> Our second objection is that the amendment opens up a major loophole which would allow unscrupulous landlords to put their properties outside the right to manage.[152]

Lord Kingsland returned to the matter at Third Reading where he sought to dis-apply Chapter 1 of the Bill to any part of a building not occupied or intended to be occupied for residential use.[153] His amendment was negatived on a division. Lord Falconer said that the Government had considered seriously the representations of those groups who felt that the RTM would inhibit the development of mixed-use premises and had concluded that they were "unfounded."[154]

On the question of excluding premises where over 25% of the internal floor area is in non-residential use, Lord Jacobs, in Grand Committee on the first Bill, raised the possibility of excluding basement storage areas and garages from the equation; this question was also raised in discussions over enfranchisement.[155] Lord Whitty responded that "the totality of the property which was in the residential part should count towards the residential quota and likewise on the other side of the equation."[156]

The decision not to extend the RTM to lessees of council blocks was questioned during the consultation process. The Chartered Institute of Housing (CIH) views the public sector right to manage scheme as "inferior" to the RTM that *would* apply to registered social landlords (RSLs).[157] The Institute said that the disparity between the two schemes "will create yet another anomaly between the rights of RSL tenants and public sector tenants which will make the introduction of a single tenancy[158] more difficult to

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[152] HL 13 November 2001 c 483
[153] HL Deb 19 November 2001 c 912
[154] HL Deb 19 November 2001 c 912
[155] HL Deb 27 February 2001 CWH 113
[156] HL Deb 27 February 2001 CWH 115
[157] Also referred to as housing associations.
[158] Currently new tenants of RSLs are assured tenants while council tenants are secure tenants. The creation of a single tenancy to cover all tenants in social housing has been widely discussed.

achieve."[159] A majority of leaseholders think that the RTM should apply to local authority freeholders.[160] An amendment moved by Lord Kingsland to the first Bill in Grand Committee, which would have applied the RTM to local authority premises, was unsuccessful.[161]

Lord Goodhart sought clarification, when debating the first Bill, on why the RTM would not apply to premises where the RTM has been exercised and ceased to be exercisable within the last four years.[162] He asked why it would not be possible for a new RTM company to take over from an existing one if the lessees considered that appropriate.[163] Lord Whitty responded thus:

> There are a number of circumstances where the right-to-manage will be lost. This will happen mainly where the leaseholders have proved unable to run their affairs properly. Unless we provide otherwise, there would be nothing to prevent those leaseholders immediately embarking on a second or subsequent go at the right-to-manage. It would be wrong to allow for repeat acquisition of a right in this way; an unfettered right to re-acquire right-to-manage would mean that there was no real incentive on the leaseholders to make sure that they were managing the property correctly in the first place.
>
> That said, one failure should not disqualify them forever. Aside from other considerations, there will inevitably be some turnover in the block and a point will come when there will be a new set of leaseholders who wish to exercise the right-to-manage. For that reason, we have chosen that disqualification should last for four years. This is the typical amount of time taken for a substantial turnover of leaseholders within a block to take place. From that perspective, the seven-year period proposed by the amendment of the noble Lord, Lord Kingsland, would be too long. [164]

In addition, leaseholders will have the fall-back position of applying to a leasehold valuation tribunal to dispense with the bar to setting up a new RTM company within the four year period.

b. RTM companies

In order to exercise the right to manage the qualifying leaseholders would have to form a RTM company. **Clause 71** would define a RTM company as a private company limited by guarantee which must include the acquisition and exercise of the RTM as one of its objects.

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159 CIH's response to the draft Bill, p 5
160 DETR, *Analysis of responses to the consultation paper on Leasehold Reform,* January 2001, p 10
161 HL Deb 27 February 2001 CWH 113-4
162 Paragraph 5(1) of schedule 6
163 HL Deb 27 February 2001 CWH 112-3
164 HL Deb 27 February 2001 CWH 114

During the consultation process preceding the publication of the first Bill there was agreement amongst freeholders and their representative bodies that a defined corporate structure should underpin the RTM: a majority of leaseholder respondents disagreed with this proposal.[165] The DETR's analysis of responses to the draft Bill pointed out a contradiction between this disagreement and leaseholders' support for the use of a corporate structure for collective enfranchisement and also their support for consistency between arrangements for the RTM, collective enfranchisement and commonhold.[166] Leaseholders disagreed with the proposed structure for the RTM company because of a desire to avoid "unnecessary bureaucracy" and to "keep things simple." Associated to this was a feeling that a company limited by guarantee would be off-putting because some leaseholders would not understand it.[167]

The question of whether a company limited by guarantee would be an appropriate structure for a RTM company was raised in Grand Committee on the first Bill. Lord Kingsland suggested that it would prove "wholly unworkable":

> One of the difficulties of commercial life in this country, which results in many small limited companies being unable to pay their debts, is that limited companies are under-capitalised. These RTM companies which the Government propose are not just under-capitalised but, in effect, zero-capitalised. It is essential that RTM companies have adequate working capital. Only in this way will they be able to carry out the important functions allocated to them.[168]

To get around this problem of under-capitalisation Lord Kingsland moved an amendment to the current Bill in Committee to provide for RTM companies to remain as companies limited by guarantee but with a substantial guarantee given by the tenants, ie the equivalent of two years' service charges:

> The advantage of this proposal is that an RTM company would have a borrowing capacity from the start to enable it to obtain some working capital from a bank. Yet, at the same time, the tenants would not actually have to part with money at the start. As I understand it, that was the main objection to the original proposal. Thus our amendment would lead to RTM companies being much better able to cope with the demands that they are likely to face from the outset. I commend it to the Committee.[169]

Lord Falconer responded that the amendment would make the right to manage inaccessible to the vast majority of leaseholders:

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165 DETR, *Analysis of responses to the consultation paper on Leasehold Reform*, January 2001
166 *ibid* p 11
167 *ibid*
168 HL Deb 27 February 2001 CWH 120
169 HL Deb 16 October 2001 c 543

> …it will create an incentive for the landlord to make the service charges as high as possible. Indeed, if he can make sure that the leaseholders struggle to pay them once, he can be sure that it will be impossible for them to accumulate enough to pay them effectively for a second and third time. We cannot agree to the opening up of such a glaring opportunity for landlords to undermine the right to manage.
>
> That said, I can well appreciate concerns that the leaseholders who take over the management of a property should have the necessary funds behind them to be able to do the job properly. We agree and strongly encourage them to do so. But, as has been said previously, that is a matter for guidance and not for the face of the Bill. Leaseholders already have to pay for the management of the property and will therefore exercise the right to manage, knowing that they will have to meet the costs that they run up themselves. The additional requirement is unnecessary and would be a very heavy burden.[170]

Clause 72 would make provision in respect of the membership and constitution of a RTM company. All qualifying tenants of a flat in the premises **(defined in clause 73)** would be entitled to be a member of the RTM company, as would any landlords under leases of the whole or any part of the premises (but only after the date on which the RTM company acquires the right to manage).

Regulations would specify the content and form of the Memorandum & Articles (M&A) of a RTM company **(clause 72(2))**.[171]

The proposed inclusion of the landlord as a member of the RTM company has proved highly controversial amongst leaseholders. Leaseholder respondents to the draft Bill and consultation paper disagreed strongly with the proposal to open membership of the RTM to landlords.[172] The Leasehold Advisory Service's response said that the landlord should not automatically become a member of the RTM company:

> The landlord will retain rights as a freeholder (or head lessee) and will also receive rights under RTM for inspection etc, he may also have voting rights relating to flats in his ownership. Further involvement in the management process seems both unnecessary and an intrusion on the tenants' proposed rights. With his reserved rights as freeholder and the situation that the landlord will always be in a minority and unable to influence decisions, what function is intended to be served by his inclusion in the RTM company?[173]

In Committee Lord Kingsland argued that the Bill would not protect a landlord's interest in ensuring that blocks are properly maintained because they would always be outvoted at

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[170] HL Deb 16 October 2001 c 545

[171] These would be made by the Secretary of State in England and the National Assembly for Wales in Wales.

[172] DETR, *Analysis of responses to the consultation paper on Leasehold Reform*, January 2001, p 12

[173] Leasehold Advisory Service's response to the draft Bill, para 1.6

by tenants at meetings.[174] He moved an amendment to allow landlords to sit on the board of directors so that their "legitimate interest in the property" would be recognised.[175] Alternatively, Lord Goodhart said that landlords should not be automatic members of a RTM; he thinks this will lead to conflicts of interest between the RTM and the landlord and within the RTM itself. He moved an amendment to remove paragraph (b) from **clause 72(1)** to remove landlords from membership of RTM companies except in cases where they are lessees of flats as well as freeholders.[176]

Lord Flaconer gave a detailed response to this amendment:

> Our proposed right for landlords to become members of the RTM company was the subject of some dispute when this Bill was previously before the House. Leaseholder representatives have expressed considerable concerns about it, and I appreciate that many of them are genuine. However, correspondence received by my officials on this issue suggests that a good many of those concerns are based on a misunderstanding of what is being done in this Bill. I believe that it is important, therefore, to make our intentions clear.
>
> It is true that, put in simple terms, the right to manage is a right to allow leaseholders of flats to gain management control of their block. What it is not, however, is a right to kick out the landlord. Many Members of the Committee who recall the previous Committee stage of this Bill will remember my noble friend Lord Whitty emphasising on a number of occasions that this was a "no fault" right to manage. That point has been acknowledged by the noble Lord, Lord Goodhart, in moving the amendment. That remains a key point which will continue to be stressed on our side throughout the passage of the Bill. Our emphasis on no fault is not intended to be a convenient smokescreen behind which to hide. The landlord will continue to have a legitimate property interest in the building once RTM is acquired. By the same token, the landlord will have an ongoing interest in its management.
>
> Furthermore, because the acquisition of the right is not linked to any process of proving that the landlord has been a bad or negligent manager--hence "no fault"--there is nothing which justifies our ignoring that interest and cutting the landlord entirely out of the management process. The noble Lord, Lord Goodhart, seeks to circumvent that point by saying that frequently bad management will provoke the process by which RTM is instituted. With the greatest respect to the noble Lord, that is not a sufficient answer. There is a no-fault process here. The landlord retains an interest in the property and, as a member of the RTM company, he is entitled to have that retained property right respected.
>
> I believe that there is much common ground between ourselves and the noble Lord. We disagree over how best to ensure that the landlord's legitimate interests

[174] HL Deb 16 October 2001 c 543
[175] HL Deb 16 October 2001 c 544
[176] HL Deb 16 October 2001 c 563

> are safeguarded. Our view is that the best way to provide for this is to allow the landlord to be a member of the RTM company. That will put him or her on a similar footing to any one of the qualifying leaseholders, with the same rights to receive information and to suggest the best way forward for the management of the property. I suspect that this may be seen as somewhat heretical, but it would even allow the landlord and leaseholders to work together in managing the block in which they all have a property interest.[177]

A further concern raised in Grand Committee on the first Bill was that those seeking the RTM should be made fully aware of the responsibilities that they would be taking on. Lord Kingsland moved an amendment that would have placed a duty on "the appropriate national authority" to supply RTM companies with explanatory material on the risks and responsibilities associated with the RTM.[178] Lord Williams spoke to an amendment proposing that RTM companies be required to circulate a prospectus at the beginning of the process. Lord Whitty, for the Government, conceded that there might be merit in producing guidance on good management practice but said would not be desirable to place additional requirements on the face of the Bill; he was concerned that this might provide an ill-disposed landlord with additional opportunities to challenge the RTM.[179] Lord Whitty said the Government was considering a form of guidance which, if not complied with, could constitute grounds for the appointment of a replacement manager under the *1987 Landlord and Tenant Act.*[180]

c. Qualifying tenants

Qualifying tenants would essentially be leaseholders with long leases, i.e. leases that were originally granted for a term exceeding 21 years **(clauses 74 and 75 define a long lease)**. There would be only one qualifying tenant per flat and tenants with business or commercial leases would not qualify **(clause 73)**.

Lord McIntosh clarified in Grand Committee on the first Bill, in response to an amendment moved by Baroness Maddock, that a registered social landlord who sublets a flat on an assured tenancy will automatically be the qualifying tenant by virtue of holding a long lease. Leaseholders would not have to be resident to qualify for the RTM.[181]

Lord Kingsland sought to amend **clause 73** in Committee on the current Bill to provide that a leaseholder who is not resident in the property should not enjoy membership rights of a RTM company. His concern is based on the possibility that the RTM will be exercised by companies and people who hold leases solely for investment purposes.[182] Lord Falconer rejected the amendment on the grounds that different eligibility rules

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177 HL Deb 16 October 2001 cc 565
178 HL Deb 1 March 2001 CWH 132
179 HL Deb 1 March 2001 CWH 136
180 HL Deb 1 March 2001 CWH 137
181 HL Deb 1 March 2001 CWH 144
182 HL Deb 16 October 2001 c 564

should not apply to different people and said that the Government's position was that "any form of residence test is undesirable."[183]

Lord Goodhart, in Committee and on Report, sought to limit RTM membership to people who have a "reasonably present and direct interest in the state of the premises":

> We believe, therefore, that the Government have drawn the boundary line in the wrong place. For the purposes of the RTM company, the long lease definition ought to be reduced from 21 years to seven years. The person lowest down the tree with a lease of more than seven years should be the member of the RTM company. That achieves the right balance between somebody whose interest in the premises is remote rather than immediate and somebody whose interest is for such a limited time that they are not concerned about the maintenance of the premises over the longer term. The right boundary is not 21 years but seven.[184]

Lord McIntosh conceded that there was no perfect answer to this issue; he thought that it was widely accepted that 21 years "is a fair and accurate dividing line."[185]

3. Claiming the RTM

There would essentially be five steps to this process. First, the RTM company would have to serve a notice on all qualifying tenants inviting them to participate in the acquisition of the RTM **(clause 76)**. The "notice of invitation to participate" would have to comply with the minimum requirements set out in the Bill and any specified in regulations. **Clause 109** would specify detailed requirements on the service of notices under the RTM. The Government tabled an amendment at Report stage to ensure that a "notice of invitation to participate" would not be invalidated by any inaccuracy[186] in the information contained in the notice.[187] This amendment was inspired by an amendment tabled by Lord Kingsland during the Committee stage of the first Bill.

At the Report stage of the current Bill Lord Kingsland moved an amendment to **clause 76** to provide that a "notice inviting participation" in the RTM should be accompanied by, or include, a statement setting out the principal responsibilities and obligations that the company would assume.[188] Although the Government sees merit in ensuring that those invited to take on the RTM are made properly aware of what it will involve, they are considering how this might be done in regulations under **clause 76(3)**. The Government is resistant to writing such a provision on to the face of the Bill.[189]

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183 HL Deb 16 October 2001 c 566
184 HL Deb 16 October 2001 c 573
185 HL Deb 16 October 2001 c 574
186 Deliberately misleading information will still invalidate a notice (HL Deb 13 November 2001 c 499)
187 HL Deb 13 November 2001 cc 497-8
188 HL Deb 13 November 2001 cc 495-6
189 HL Deb 13 November 2001 cc 496-7

Lord Williams of Elvel moved an amendment in Grand Committee on the first Bill to provide for the RTM company to appoint a surveyor prior to the service of a notice of invitation to participate. Lord Whitty conceded that such a provision might be needed in the Bill to ensure surveyors would have a right of access to the building and relevant documents: if not in the Bill he said it would be covered by guidance.[190]

There are no sanctions in the Bill against a RTM company that fails to send invitations to participate to all the tenants. In the Government's opinion this is not necessary:

> We do not see any advantage in prosecution. The interest of a leaseholder is not prejudiced by a failure to receive a notice of invitation to participate. The right to manage can only be acquired if a sufficient number of the leaseholders become members of the RTM company. Provided that enough of the others had signed up, anyone who does not become aware of the proposed acquisition would not be in a position to prevent it going ahead but will in any event have the right to become a member of the RTM company at any time. I believe that to be a failsafe position.[191]

Clause 77 would set out the procedures to be followed in acquiring the RTM. The company would have to serve a claim notice. This notice could only be served where the correct number of qualifying tenants are members of the company. Ordinarily this would be achieved where the qualifying tenant members hold at least half of the flats in the block. Where there are only two qualifying tenants in the block both would have to be members of the company at the time the notice was served.

The claim notice could not be served until the expiry of 14 days after each qualifying tenant has received a notice of invitation to participate. Lord Bassam rejected an amendment in Committee to extend this period to 28 days on the ground that it would introduce delay into the RTM process.[192] Lord Kingsland also questioned the handover provisions of the Bill as they would apply to contracts other than management contracts,[193] eg for ongoing building repair work. Lord Bassam preferred to debate this under clauses 89 and 90 (see page 61 below).[194]

Clause 78 would specify the minimum requirements to be contained in the claim notice. The company would have to demonstrate that it qualifies for the RTM. Recipients of a claim notice would have to respond within one month with a counter-notice. The notice would have to give a date on which it intended to take over management responsibilities: this would have to be at least one month after the last date on which a counter-notice could be served.

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190 HL Deb 1 March 2001 CWH 155
191 HL Deb 16 October 2001 c 576
192 HL Deb 16 October 2001 cc 579-81
193 Management contracts are covered by clauses 89 and 90 of the Bill.
194 HL Deb 16 October 2001 cc 579-82

In Grand Committee on the first Bill discussion took place over the need for "health warning" provisions in the notice. Lord Kingsland argued for the inclusion of a statement to the effect that the RTM company had secured an offer of appropriate insurance cover.[195] At Third Reading stage of the current Bill he moved an amendment to require the RTM company to include an offer of liability insurance in its claim notice.[196] Lord Bassam of Brighton, for the Government, argued that such a provision would undercut the philosophy behind the right to manage; namely, that leaseholders should have the right to a say in the management of their own block by virtue of their investment in the property. He confirmed that RTM companies would be expected to take out such insurance and that this would be encouraged in guidance. He pointed out that no other property owner is required by law to take out liability insurance "just because they want to manage and maintain their home."[197]

Clause 79 would make supplementary provisions in respect of the claim notice. It would provide that a notice would not be invalidated by any inaccuracies in the details or its form. In Grand Committee on the first Bill Lord McIntosh explained that this provision would prevent a landlord from rejecting a claim notice; landlords would still be able to dispute an entitlement to the RTM.[198]

The RTM company would be able to require the provision of information that is reasonably required for the purposes of acquiring the RTM **(clause 80)**; this would have to be provided within 28 days of request. In Committee on the current Bill Lord Kingsland argued that this clause[199] was, as drafted, "too wide and too vague." He said it was an invitation for disputes to arise and had no sensible enforcement mechanism.[200] On Report Lord Bassam moved a Government amendment saying that Lord Kingsland's arguments in Committee had persuaded them that "there was merit in clarifying the application of the clause."[201] The clause was duly amended to make it clear that the power granted by it may be used only to obtain information that the RTM company is required to include in the claim notice by virtue of **clause 79**. No amendments were made to include an enforcement mechanism; the powers contained in **clause 103** are relevant to this issue.

Clause 81 would grant the RTM company and any recipient of a claim notice, or anyone acting on their behalf, a general right of access to any part of the premises if needed in connection with the claim to acquire the RTM.

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195 HL Deb 1 March 2001 CWH 158-9
196 HL Deb 19 November 2001 cc 916-7
197 HL Deb 19 November 2001 cc 917-8
198 HL Deb 1 March 2001 CWH 163
199 Which was then clause 77.
200 HL Deb 16 October 2001 cc 577-8
201 HL Deb 13 November 2001 c 500

Clause 82 would specify the procedures governing the issue of counter-notices. A counter-notice would have to be served by the date specified in the claim notice and may only admit or deny the RTM claim. In the latter case the notice would have to state the grounds on which the company is considered not to comply with the Bill's eligibility criteria. A RTM company would be able to apply to a leasehold valuation tribunal (LVT) for a determination of its eligibility within 2 months of receiving a counter-notice. A claim notice would have no effect if a LVT determines that the company was not entitled to acquire the RTM.

In Grand Committee on the first Bill Lord Kingsland moved a series of amendments to what was then clause 81 which he described as "very important to this side of the Committee." He suggested that the amendments were "essential to make the Bill compliant with the Human Rights Act."[202] In essence the amendments would have given a LVT a duty to determine whether a block on which a RTM claim had been lodged would be better managed by the landlord or the tenants. He said:

> If these amendments are not accepted, it seems to me that the Government will have great difficulty in showing that a landlord's human rights have not been infringed. As I said in setting out the Opposition's approach to this part of the Bill, the right to manage is a valuable one. Landlords quite legitimately, in order to manage blocks of flats, have those rights. It is justifiable to take away that right without compensation if the landlord is abusing his position. This kind of case would plainly satisfy the Duke of Westminster criteria set down by the European Court of Human Rights.
>
> What is not justifiable is taking away not only profits of managing but also potentially damaging the landlord's reversionary interest in cases where necessary repairs are likely to be postponed. There is simply no pressing social need for that kind of expropriation without compensation. That is why giving the leasehold valuation tribunal the power to carry out a balancing exercise in important. The message which needs to go out from this Committee is that Parliament condemns bad landlords but supports good landlords.[203]

Lord McIntosh responded that leaseholders with the greatest share of the equity in a building should have the right to manage that investment without having to prove shortcomings on the part of the landlord or prove that they are more suitable managers. He also referred to other "safeguards" in the Bill that could be used in the event of the RTM company failing to manage the building properly.[204] Lord Kingsland later moved an amendment to insert a new clause that would "insure that a safety net is in place if a RTM company takes over management and things go wrong."[205] Lord McIntosh responded that the same arguments applied and pointed out that tenants would have the right under the

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[202] HL Deb 1 March 2001 CWH 163-4
[203] ibid
[204] HL Deb 1 March 2001 CWH 165-6
[205] HL Deb 1 March 2001 CWH 170-1

schedule 7 to the *1987 Landlord and Tenant Act* to seek the replacement of a RTM company.[206]

Lord Kingsland returned to the matter during the Committee stage of the current Bill with a "circumscribed" amendment to allow a landlord to oppose an application for the RTM if s/he can show severe prejudice, eg "the short lease where the lessees intend to avoid carrying out necessary repairs."[207] Once again the Government resisted this amendment but Lord McIntosh conceded that it should be possible for a leasehold valuation tribunal (LVT) to order the cessation of the RTM: an amendment to allow a LVT to make an order for the cessation of the right to manage was duly moved on Report. After such an order management will revert to the landlord.[208]

Clause 83 would provide for the situation where no party can be found to serve a claim notice upon. A RTM company would be able to apply to a leasehold valuation tribunal to acquire the right to manage.

Clause 84 would make provision for the withdrawal of a claim notice.

Clause 85 would set out the circumstances in which a claim notice would be deemed to have been withdrawn, for example where a RTM company failed to respond to a counter-notice disputing the claim within the requisite two months. This clause was amended on Report to ensure that a claim for the RTM would not be struck out accidentally where a landlord withdraws his objections to the acquisition of the RTM after an application to the LVT has been made on this issue.

Clause 86 would specify that any recipient of a claim notice would be able to recover from the RTM company the reasonable costs incurred in dealing with the notice. These costs would not include the cost of disputing a claim at a LVT unless successful.

Clause 87 would make provision for liability for costs where a claim notice ceases to have effect, for example where a notice is withdrawn.

4. Acquisition of the RTM

Clause 88 would make provision for determining the date on which a RTM company would acquire the right to manage (the acquisition date).

Clauses 89 and 90 would place an obligation on the manager of the premises, where the right to manage is acquired by a RTM company, to serve notices in respect of management contracts entered into prior to the date on which the company would take

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206 HL Deb 1 March 2001 CWH 171
207 HL Deb 22 October 2001 cc 819-20
208 HL Deb 22 October 2001 cc 821-23

over management of the premises. The Explanatory Notes to the Bill state that "these requirements are intended to allow all parties employed in the management of the premises to make the necessary arrangements to prepare for the company taking over the management of the premises."[209]

A series of notices would have to be served. The existing manager would have to serve a "contractor notice" on contractors s/he has employed notifying them that the RTM had been exercised and the date on which the RTM company would take over. The RTM company would also be served with "contract notices" informing them of existing contract arrangements. Contractors would be required to serve a contractor notice on any sub-contractor employed in the management of the premises in question; they would also serve a contract notice on the RTM company to notify it of the existence of any sub-contractors.

These clauses have given rise to some confusion. During the clause stand part debate on clause 88 of the first Bill (now clause 89) Lord Kingsland said that he was not convinced that the Government's intentions were clear and that clauses 88 and 89[210] could pose practical problems. He appreciated that there was a desire to transfer existing contracts to the RTM company only if both the contractor and company agreed[211] but noted that it was not clear what would happen to existing contracts once the relevant notices had been served. He went on to raise the issue of compensation for frustrated contracts and the possibility that contractors' decisions to continue with contracts might be influenced by the financial strength of the RTM companies.[212] Lord Goodhart saw no reason why there should be automatic termination of a contract or why the RTM company should have power to terminate a fair and reasonable contract. He suggested that contracts in existence should be subject to a review and that a power to terminate contracts on certain specified grounds should be inserted, eg where the services provided are inappropriate.[213]

Lord Kingsland returned to the matter during the Committee and Report stages of the current Bill. He moved an amendment that would have provided for the continuation of management contracts unless the contractor and RTM agree otherwise within 28 days after the service of a contract notice.[214]

Responding, Lord Falconer set out how the Government envisage the Bill's provisions will work:

> This is an important issue, in relation to which three points of view are possible. The first, which is in the Bill, is that the normal law should take its course. The

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[209] HL Bill 51-EN para 162
[210] Now clauses 89 and 90
[211] To prevent a RTM company from being bound by 'sweetheart contracts' that benefit the landlord.
[212] HL Deb 1 March 2001 CWH 172-3
[213] HL Deb 1 March 2001 CWH 173-4
[214] HL Deb 22 October 2001 c 841 & HL Deb 13 November 2001 cc 505-6

second view is espoused by the noble Lords, Lord Kingsland and Lord Goodhart, who, in slightly different ways, want to force the old contract on to the RTM. The third view is that of my noble friend Lord Williams of Elvel, who states that the arrangement should be null and void in every case once RTM has been passed or accepted as the way forward. I shall set out what I submit is the current position under the Bill and then deal with the conflicting propositions.

There was some confusion about this issue when it was discussed during the Committee stage of the previous Bill. Where a party to a contract is placed by events that are outside his control in the position of no longer being able to fulfil his obligations or role under that contract, the normal effect of contract law will be that that contract falls as frustrated. That is effectively what the noble Lord, Lord Goodhart, said. One such case is that in which the operation of law intervenes to prevent someone from being able to fulfil his part of a contract. Whether that will happen with RTM companies will depend on the facts of each case.

Leaseholders have the right to take over management, subject to having met the qualifying rules. A landlord will not be able to prevent a qualifying group from doing so. Acquisition of RTM is therefore a compulsory, not a voluntary, transaction. Furthermore, Clause 95(2) provides that, following the acquisition of the right, the landlord cannot continue to exercise any of the duties that have become "management functions" of the RTM company. Operation of law will therefore mean, for example, that the landlord will no longer be responsible for the maintenance of the property. Frustration may be the outcome. I do not of course suggest that that would necessarily be the position in each and every case. The application of the law of frustration and the law of contract generally will of course depend on the circumstances of the case.

Where a contract is frustrated in the circumstances that I have described, each party to that contract will have the right to recover moneys due to them under it for what has been done up to the point of frustration. The contractor will be able to recover from the other party all sums due for the work that has been done up to the point of frustration. The other party will in turn be able to recover from the contractor any sums advanced prior to that point for works that will not now be carried out. Neither party will have any right to seek compensation for any profits foregone or other such matters as a result of the frustration of the contract. We think that that is both right and fair.

The noble Lord, Lord Goodhart, suggested, during this Bill's Committee stage and during the previous Bill's proceedings, that there would be circumstances in which the employment of a particular contractor, such as a gardener, would transfer to the RTM company. We agree that that will be the result of employment law, and particularly of the rules that relate to the protection of employment following the transfer of an undertaking--TUPE--rather than of general contract law. As my noble friend Lord Whitty said during the Committee stage of the previous Bill, nothing in the Bill overrides such employment rights; nor would we wish it to do so.

> Whether a particular employee or contractor would pass to the RTM company depends on whether the acquisition of the right to manage constitutes a transfer of undertaking for those purposes. As noble Lords know, this is a complex area and the application or otherwise of TUPE will depend on the individual circumstances of the case. However, we are perfectly content that, when it does apply, the employment of the individual in question should be part of the right to manage company.
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> The noble Lord, Lord Kingsland, asked today and during our debate on Thursday what would happen to contractors, such as builders, who repair the property. Clause 94(5) makes it clear that repairs will be one of the management functions of the RTM company where the right to manage is acquired. That will be another function that the landlord will be debarred from continuing to carry out by virtue of Clause 95(2).
>
> As for maintenance, contracts by which the landlord delegated his responsibilities for repairs would normally be frustrated. I also make it clear to the noble Lord that because repairs will be a matter for the RTM company once the right to manage is acquired, a repair contract of the kind that he described would be a management contract, as defined by Clause 89(2).
>
> I have set out at some length what the Bill's current effect would be--it is important to do so. In effect, its current effect is that the normal law will apply to determine what happens to the contracts after the RTM company takes over.[215]

Lord Kingsland reiterated his belief that these provisions could have an adverse effect on the willingness of contractors to enter into long-term contracts with existing blocks of flats.[216] On Report Lord Goodhart spoke to an amendment to provide for the statutory novation[217] of existing contracts.[218] Lord Falconer rejected this amendment to clause 90 on the grounds that it would not give contractors the right to decide whether or not to work for an RTM company.[219]

Clause 91 would place an obligation on any landlord, third party to a lease or manager appointed under the 1987 Act, to provide on request, any information required by the RTM company as a result of the RTM being exercised. In Grand Committee on the first Bill there was some discussion over the timescale allowed for the handover period. The Bill would provide for a request to be complied with within 28 days, subject to the proviso that any party would not be compelled to hand over any information under clause 91 within 4 months of the date of the claim notice or the date on which the RTM company takes over management (whichever is the later). The Earl of Caithness moved

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215 HL Deb 22 October 2001 cc 843-5
216 HL Deb 22 October 2001 c 847
217 All contracts would carry over but the RTM company would have the right to terminate individual contracts on specified grounds.
218 HL Deb 13 November 2001 cc 506-7
219 HL Deb 13 November 2001 cc 507-9

an amendment to reduce this period to 3 months; he argued for an overlap period and a regular flow of information between the parties for at least 2 months before the RTM company takes over.[220] Lord Williams of Elvel questioned the ability of the RTM company to function without having immediate access to uncommitted service charges on the date of acquisition.[221]

Lord Whitty, for the Government, said that the arrangements in the Bill on handover had been drawn up after extensive consultations and represented a compromise between the various conflicting concerns:

> We would be reluctant to move away from those arrangements. There will be many situations where an element of co-operation will enable the parties to agree sensible arrangements for the transfer of responsibility and to agree sensible timetables--the provisions in the Bill allow plenty of scope for that--but where there is an element of antagonism or mistrust, leaseholders would almost certainly wish to gain control as rapidly as possible. In such cases, they would need to accept a temporary period of inconvenience and may need to finance expenditure arising. Nevertheless, the issue as to who was controlling the building would be resolved.
>
> Nothing is completely satisfactory in this area. We believe that our provisions are better than those contained in the amendment.[222]

Clause 92 would place an obligation on any landlord, third party to a lease or manager appointed under the 1987 Act to pay over to the RTM company any sums held on behalf of the tenants in respect of the premises on the acquisition date. They would not be required to hand over sums needed to meet costs incurred before the right was exercised. The same time limits and provisos would apply as under clause 91. In Grand Committee on the first Bill Lord Goodhart raised the question of certainty of costs. He pointed out that a landlord might not pay the full amount due under a building contract if s/he believed that the work was not up to standard. In these circumstances he thought that the landlord should be obliged to hand over the balance to the RTM company.[223]

5. Exercising the right

Clause 93 would provide for **clauses 94 to 101** to apply while the RTM company is responsible for the management of the premises. **Clause 94** would set out the functions, duties and responsibilities taken on by the RTM company by virtue of acquiring the RTM. Clause 94(5) and (6) would define the management functions to be taken on by the company. The company would not be responsible for management of any unit that is not

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220 HL Deb 1 March 2001 CWH 177-8
221 *ibid*
222 HL Deb 1 March 2001 CWH 178-9
223 HL Deb 1 March 2001 CWH 179-80

held by a qualifying tenant (eg a commercial unit or flat of a tenant on a short lease) but would be responsible to all parties for the management of the common parts and fabric of the building.

In Grand Committee on the first Bill Lord McIntosh of Haringey confirmed that the company would have to comply with any statutory requirements that are binding upon it as a manager, eg health and safety requirements.[224] Lord Goodhart said that the division of management responsibility in blocks with some qualifying tenants and some non-qualifying tenants would be "unworkable". He argued for the RTM company to be entitled and required to take over the management of all units served by the same common parts irrespective of whether they have qualifying leaseholders.[225] Lord McIntosh responded:

> Our objective is to provide long leaseholders, who have made a substantial investment in their own homes, with the right to manage the building as a whole. We do not consider it appropriate that they should be able to interfere in the relationship between the landlord and short-term or commercial tenants. It is not our intention to provide other tenants, who will not normally have made a substantial investment in their premises, with the right to manage.[226]

Clause 95 would make further provision in respect of the management functions of the RTM company. It would set out to whom obligations are owed by the RTM company and, in turn, who would owe the company obligations. Lord Goodhart expressed concern in Grand Committee on the first Bill that landlords might try to harass RTM companies by taking them to court to maintain standards of repair at a higher level than that actually required. Lord McIntosh reiterated the fact that the main sanction against a RTM company would be the appointment of a new manager under Part II of the *1987 Landlord and Tenant Act.* He also drew attention to the fact that leasehold valuation tribunals would get additional powers to deter "frivolous and vexatious" applications.[227]

Lord Kingsland moved an amendment in Committee on the current (and first) Bill to insert a new clause that would have required a building to be covered by a single insurance policy representing best value for the service charge payers. When moving the amendment in Grand Committee on the first Bill he referred to the case of Rose Court in Putney which was destroyed by a gas explosion in 1985. The individual leaseholders had been responsible for insuring their own flats and because some had failed to make adequate arrangements for restitution the insurance cover fell short of the cost of reinstating the building.[228] Lord Whitty, responding, advised that although the Government had some sympathy with the amendment, it preferred to make the absence of

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[224] HL Deb 1 March 2001 CWH 181
[225] HL Deb 1 March 2001 CWH 181-2
[226] HL Deb 1 March 2001 CWH 183
[227] HL Deb 15 March 2001 CWH 187-8
[228] HL Deb 15 March 2001 CWH 189-10

a requirement to take out a single insurance policy grounds for a lease variation.[229] He noted that it would be wrong to place more stringent requirements in respect of insurance on RTM companies than those that apply to other landlords/property managers.[230] Lord Falconer repeated these arguments in Committee on the current Bill.[231] Lord Kingsland's new clause was negatived on a division of the Committee.[232]

Clause 96 would specify the procedure to be followed under the RTM where an approval is required under the lease.[233] **Clause 97** would specify the procedure to be followed where a landlord objected to the granting of an approval under clause 96. **Clause 98** would provide for a RTM company to take action to enforce tenants' obligations under their lease agreements. **Clause 99** would require a company to monitor tenants' compliance with the terms of their lease agreements and to report to the landlord any breaches that are not put right within 3 months of them first coming to light.

At Committee stage Lord Kingsland moved amendments to limit the powers of the RTM company to grant approvals. He was concerned that the RTM company should not be able to grant approvals that might have a detrimental effect on the landlord's reversionary interest.[234] The Earl of Caithness moved a similar amendment on Report.[235] Lord Falconer, in response, said that the safeguards for landlords were sufficient:

> …where the RTM company proposes to grant a consent, clause 96(4) provides that it must first give written notice of that intention to the relevant landlord. The landlord then has the opportunity to decide whether to agree or object to the granting of that consent and to notify the RTM company accordingly. Where a landlord decides that he wishes to object the RTM company may grant the approval only if one of two conditions are met. First, the landlord must agree to withdraw the objection. Alternatively, an application must be made to a leasehold valuation tribunal for its agreement that the approval should be granted.
> We believe that these arrangements already make admirable provision for the safeguarding of the landlord's legitimate interests.[236]

Lord Kingsland also moved amendments during the Grand Committee stage of the first Bill that would have required a RTM company to assist and co-operate with a landlord who decided to step in and enforce a covenant, and to render the company liable to compensate the landlord for any loss arising from a failure to monitor and report on breaches of covenants. A further amendment would have provided for companies to

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229 This is provided for in clause 157(2) (see pages 96-97)
230 HL Deb 15 March 2001 CWH 190-1
231 HL Deb 22 October 2001 cc 850-51
232 HL Deb 22 October 2001 cc 852- 3
233 An approval might be required, for example, where a leaseholder wants to carry out structural works.
234 HL Deb 22 October 2001 c 854
235 HL Deb 13 November 2001 cc 509-10
236 HL Deb 13 November 2001 cc 510-11

reimburse landlords' court costs.[237] Lord Whitty enlarged on the provisions of clauses 97 and 98 (now clauses 98 and 99) when responding to these amendments:

> Clause 97 [*now 98*] already ensures that the RTM company can enforce any of the tenant covenants itself. That is needed so that we can ensure that they can exercise proper management control over the premises and deal with problems that arise, either with the building or with disputes between tenants, where someone breaches the terms of their lease. Because a breach of lease can in some cases, like those concerning the amendment of the noble Lord, Lord Kingsland, affect the landlord's reversionary interest, we have not taken away their right to take enforcement action. So the landlord and the company will both have rights in parallel to one another here.
>
> Clause 98 [*now 99*] sets out the responsibilities of the RTM company in respect of monitoring compliance with covenants. I should make clear that this should not be interpreted as being too heavy-handed, but a good leasehold manager will be expected to keep an eye on compliance with covenants and we therefore expect the same from the RTM company. It is also important, as the noble Lord, Lord Kingsland, said, that the landlord knows if a breach is causing long-term harm to his reversionary interest. We are therefore requiring the RTM company to inform the landlord of any breaches which are not put right within three months of their coming to the attention of the company.
>
> Beyond that, we do not see any requirement on the company to have any further explicit requirement to co-operate with the landlord in this manner, because the RTM company itself is under an obligation to enforce the covenants. As such, the company could not be anything but failing in its duties if it were preventing those covenants being enforced. Therefore, that is already covered by the obligations of the RTM company in the Bill.[238]

Lord Whitty rejected the compensation amendment on the ground that the landlord would have a civil right to take action for a failure to comply with a statutory requirement. He went on to state that if a landlord chose to take enforcement action the cost of doing so must fall on him or her, and not on the RTM company.[239]

Clause 100 would give effect to **schedule 7**. Schedule 7 would make consequential amendments to existing rights and duties to make them applicable where a RTM company acquires the right to manage.

Clause 101 would place the landlord under an obligation to meet any shortfall in the costs recovered by the RTM company caused by the proportions payable by tenants under their

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[237] HL Deb 15 March 2001 CWH 192-3
[238] HL Deb 15 March 2001 CWH 194
[239] *ibid*

leases failing to add up to 100 per cent of the total. Lord Whitty explained the purpose of this clause in Grand Committee on the first Bill:

> As you may know, in this area long leases will normally make the leaseholder responsible for paying the service charges, and in a block of flats that will normally be accompanied by a provision to set out how the overall service charge liability is divided up. In many cases, that is on a fairly straightforward basis of their shares, but in some blocks the leases will set down the precise proportion that each leaseholder must make, which may have been based on all kinds of formulae in the past.
>
> Logic suggests that where this applies, the proportions however arrived at, should add up to 100 per cent. Regrettably, however, there are instances where they do not, and that may be because the leases themselves are defective--and there are rights to correct that. But it may also be that the leases were deliberately set to come out to less than 100 per cent in recognition of the fact that the landlord holds some of the units or some of the territory and therefore meets a share of the costs.
>
> To take a simple example, if one flat in a block of four is held by the landlord, each of the leaseholders has to contribute only 25 per cent. Where that applies--and unless we provide otherwise--the newly created RTM company will find itself faced with a shortfall. Of course, the company could seek to amend the leases, but it does not seem right that it should necessarily have to do so. If the landlord met a fixed share of the cost when he was the manager, we consider that he should continue to do so when the RTM company is in effect the manager. Clause 100 is designed to do that.[240]

Discussion in Grand Committee on this clause focused on the how the proportion of costs that a landlord might be required to pay should be calculated. The Earl of Caithness sought to replace the requirement that the proportion payable be calculated with reference to the internal floor area with a choice of alternative formulae.[241] Lord Whitty preferred to keep one method of calculation to "minimise the opportunity for landlords to be obstructive", however, he said the Government was not irrevocably wedded to using floorspace and would look at alternatives.[242]

6. Supplementary provisions

Clause 102 would amend the *Land Registration Act 1925* to make the right to manage a registrable interest in land.

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[240] HL Deb 15 March 2001 CWH 197-8
[241] HL Deb 15 March 2001 CWH 196
[242] HL Deb 15 March 2001 CWH 197

Clause 103 would specify the circumstances in which the company would cease to be entitled to exercise the right to manage.

Clause 104 would provide that any agreement that has the effect of either restricting the ability of a tenant to participate in the RTM, or penalising the tenant as a result of an action of the RTM company, would be void.

Clause 105 would provide that any interested party might apply to a county court to enforce any obligation imposed by virtue of Chapter 1 of the Bill.

Clause 106 would apply the right to manage to the holdings of the Crown Estate and the Duchies of Cornwall and of Lancaster and to Government properties. Leaseholders in such premises would therefore be eligible to acquire the right. It would also enable the Duchies of Lancaster and of Cornwall to make any payments required of it as a landlord under Chapter 1 of the Bill out of either revenue or capital funds.

Clause 107 would provide for trustees who are the qualifying tenant of a flat to become members of the RTM company, unless the instrument regulating the trust specifically provides otherwise.

Clause 108 would provide for regulations to make further provisions governing the procedure for giving effect to a claim notice.

Clause 109 would set out the procedures to be followed in serving any notice under Chapter 1 of the Bill.

C. Collective enfranchisement: leasehold flats (clauses 112-125)

Enfranchisement is a right of compulsory purchase that is given for specific reasons of public policy. Most owners of leasehold houses have enjoyed the right to buy the freehold of their property or extend their lease agreements since the enactment of the *1967 Leasehold Reform Act.* Leasehold flat owners gained the "right of first refusal" where their landlord wants to sell the freehold under Part 1 of the *1987 Landlord and Tenant Act;* they also gained the right to acquire the landlord's interest in cases of continued bad management. Soon after implementation this Act was criticised for loopholes in the procedures laid down for the sale of the freehold: while it was one step on the road to strengthening the rights of long leaseholders, the overall impact of the 1987 Act has been limited. Research carried out by the Department of the Environment in 1991 and the Consumers' Association in 1992 confirmed the existence of loopholes in the legislation and highlighted the pressure placed on tenants, legally, financially and managerially, that deter them from exercising their rights under it.

The *1993 Leasehold Reform, Housing and Urban Development Act* gave most long leaseholders in blocks of flats the collective right to buy the freehold of their blocks, or individually extend their lease agreements, irrespective of whether their freeholders want to sell.

Relatively few leasehold occupiers in blocks of flats have successfully exercised their collective right to buy the freehold using the provisions of the 1993 Act. In a survey carried out on behalf of the Department of Environment, Transport and the Regions (DETR)[243] it was found that only 9 leaseholders in the sample (4%) had negotiated the entire formal process of enfranchisement under the 1993 Act. Forty leaseholders in the sample (16%) had enfranchised informally by reaching agreement with the freeholder outside the legally prescribed procedures.

Problems cited by the leaseholders in the DETR sample included the complexity of the process, problems associated with receiving informed professional advice and representation, and the uncertainty of the financial costs involved.

The Leasehold Advisory Service (LEASE), which was set up in order to assist leaseholders wishing to exercise their rights under the 1993 Act, listed several problems with the legislation in its 1995 Annual Report.[244] Many of these findings (listed below) were confirmed by the DETR's 1998 survey:

- the valuation formula is too complex;
- leaseholders fear the costs involved in the process;
- the rules on eligibility are complex; the residence test and limit on the percentage of the building that can be in commercial use have been particularly problematic;
- landlords have used evasion tactics such as delaying tactics, serving sham counter notices and embarking upon major works in order to drain leaseholders of funds that could be spent on the purchase.

The Government issued a consultation paper, *Residential Leasehold Reform in England and Wales,* in November 1998. The proposals set out in this paper were aimed, *inter alia*, at "making the collective enfranchisement of blocks of flats far easier and reducing the need for professional advice."[245]

After considering responses to the consultation paper it was announced in the Queen's Speech on 17 November 1999 that a draft Bill would be published on leasehold and commonhold reform. On 20 December 1999 Nick Raynsford announced the publication of the DETR's analysis of responses to the 1998 consultation document[246] and also the publication of a summary of proposals that were likely to be included in the draft Bill. The draft Bill and a further consultation paper were published in August 2000.[247]

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243 *The Impact of Leasehold Reform,* July 1998

244 At this time the service had been in operation for 17 months.

245 Detail on the content of the consultation paper and responses to it can be found in the Library standard note *Leasehold Reform,* 22 December 1999

246 DETR *An Analysis of Responses to Residential Leasehold Reform in England and Wales – A Consultation Paper,* December 1999

247 Cm 4843

On enfranchisement the draft Bill included measures that were aimed at:[248]

- simplifying and relaxing the existing criteria for exercising the right of enfranchisement and removing barriers for which there is no clear policy rationale;
- reducing the likelihood of lengthy and costly disputes about the determination of the purchase price of the freehold interest;
- allowing all qualifying tenants an opportunity to participate in the enfranchisement; and
- providing a standardised, purpose-built company structure for the orderly and democratic conduct of the enfranchisement process and the subsequent management of the building, after enfranchisement.

In January 2001 the DETR published a summary of responses to the draft Bill and consultation paper to which 1,065 responses were received: three-quarters were from leaseholders and the remainder were from freeholders, professionals, social landlords and "others".[249]

Chapter 2 of the current Bill would amend the right to collective enfranchisement which is governed by Chapter 1 of Part 1 of the *1993 Leasehold Reform, Housing and Urban Development Act* **(clause 112)**.

Long leaseholders have generally welcomed the Government's proposals on leasehold enfranchisement but with reservations. The Coalition for the Abolition of Residential Leasehold (CARL) wanted to see the abolition of leasehold tenure; it sees leasehold tenure as the root cause of all of leaseholders' problems and believes that no amount of legislation will "plug the loopholes and prevent the exploitation of leaseholders."[250]

From the landlord's point of view, the British Property Federation (BPF) has said that it is able to support most of the Government's proposals to ease the process of collective enfranchisement but believes that it is important to keep in mind a statement made in the 1998 consultation paper:

> Enfranchisement is a right of compulsory purchase, given for specific reasons of public policy, and firm rules are needed to ensure that it is not abused for speculation by unrepresentative minorities.

1. The qualifying rules

The current law prevents leaseholders of flats applying to buy the freehold if more than 10% of the building is occupied for commercial purposes. **Clause 113** of the Bill would

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248 Cm 4843, para 18
249 DETR, Analysis of responses to consultation on leasehold reform, January 2001, para 2.5
250 CARL's response to *Residential Leasehold Reform in England and Wales,* March 1999, p 2

increase this percentage to 25% enabling more leaseholders living above commercial premises to qualify.

During the consultation phase the British Property Federation (BPF) expressed reservations about this proposal. It argued that commercial property management required specialist skills without which the value and marketability of the building as a whole may decline.[251] The BPF said it would rather see an arrangement whereby residents in buildings with more than 10% and less than 25% of the total floorspace in commercial use were able to form a management company that would require the freeholder to grant it a 999 year head lease on the building at a peppercorn rent. In turn, the management company would be required to lease the non-residential element back to the freeholder on a similar basis enabling the freeholder to retain control over the commercial elements. Long leaseholders would prefer that the 25% restriction was removed altogether.

The BPF's concerns were reflected in the speech of Lord Kingsland during the clause stand part debate in Grand Committee on the first Bill. He said that there were indications that investors and funders were already resisting proposals to develop new mixed-use buildings that included less than 25% non-residential use.[252] He moved an amendment during the Report stage of the current Bill to delete clause 113 from the Bill. In so doing he expressed concern over the retrospective effect of the clause on mixed-use premises with between 10 and 25% of the building in commercial use. He also argued that residential enfranchisers were, in the main, "wholly unsuited" to become commercial property managers.[253] Responding, Lord McIntosh recognised that this was a "difficult and contentious area" but maintained that where leaseholders hold the majority interest "it is only right that they should be able collectively to buy out the landlord." He hoped that new mixed-use schemes would be developed on a commonhold basis.[254]

In Grand Committee on the first Bill Lord Goodhart moved an amendment to clause 113 to try and exclude storage areas, garages and parking areas from the calculation of the extent of commercial and non-commercial floorspace in a block.[255] Earlier in the Committee stage Lord Jacobs unsuccessfully moved a similar amendment in respect of premises to which the right to manage would apply. Lord Whitty responded that such an amendment could have the effect of making it less easy for mixed-use blocks to enfranchise as residential units would often have storage areas and garages; the amendment was withdrawn.[256]

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[251] BPF's response to the draft Bill, para 15
[252] HL Deb 15 March 2001 CWH 206
[253] HL Deb 13 November 2001 cc 512-3
[254] HL Deb 13 November 2001 cc 513-4
[255] HL Deb 15 March 2001 CWH 204
[256] HL Deb 15 March 2001 CWH 205

Clause 114 would abolish the low rent test. Currently individual leaseholders must hold a long lease at a low rent (if the lease has less than 35 years left to run) in order to be a "qualifying tenant" and be eligible to take part in enfranchisement.[257]

Leaseholders are also currently prevented from enfranchising a property where it is a converted property with four or fewer units and the freeholder (or an adult member of his or her family) has lived in one of the flats as his or her main home for the last twelve months.[258] **Clause 115** would amend this provision to exclude properties with a resident landlord from enfranchisement only where the landlord owned the freehold prior to conversion (this will protect freeholders who sub-divide their own home into flats and continue to live there). Where the freehold is held on trust, the exemption would only apply where the person, or at least one of the persons, occupying one of the flats as their only or principle home for at least 12 months, had also been a beneficiary of the trust since before conversion.

Under current rules at least two thirds of the qualifying tenants in the block must participate in the service of an initial notice of claim to exercise the right of collective enfranchisement.[259] **Clause 116** would remove this requirement but the notice will still have to be served by at least half of the qualifying tenants in the block. Not only does section 13(2) of the 1993 Act require two thirds of qualifying tenants to serve the initial notice, it also requires that at least half of that group must satisfy a residence test. **Clause 117** would remove the residence test requirement. Satisfying the residence test has proved to be one of the major obstacles to collective enfranchisement and its removal has been welcomed by long leaseholders.[260] In Committee on the current Bill Lord Kingsland moved that a new clause be inserted after clause 114 that would have reformed, rather than abolished, the residence test. His central concern was that the absence of a residence condition would enable foreign companies owning all the flats in a block for investment purposes, to buy the freehold.[261] Lord McIntosh defended the abolition of the residence test:

> First, we cannot agree that different eligibility rules should apply to different people. We think that there should be one governing criterion; namely, whether a person has a significant stake in the property in question. The Bill is based on that principle. Secondly, we are generally of the view that any form of residence test is undesirable. Experience has shown that tests of this nature are open to abuse and confusion.

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[257] Section 5(1) of the 1993 Act.
[258] Section 10 of the 1993 Act.
[259] Section 13(2) of the 1993 Act.
[260] DETR *An Analysis of Responses to 'Residential Leasehold Reform in England and Wales – A Consultation Paper*, December 1999
[261] HL Deb 22 October 2001 cc 857-8

> We believe that these principles are equally valid for the right of collective enfranchisement. The residence test has proved to be the greatest barrier to groups of leaseholders who wish to enfranchise.[262]

The Earl of Caithness moved an amendment to delete clause 117 on Report.[263] He raised the question of head lessees[264] being able to buy the freehold interest in the absence of a residence test:

> That leads me on to the more serious consequences. Let us imagine the situation of a traditional house in London which would qualify under the 1967 Act for enfranchisement. That house is let to a head lessee who has sublet the flats--let us say there are six of them--on a co-terminus basis, so there is no reversionary interest to speak of to the head lessee. The Bill has granted that head lessee the right compulsorily to purchase the freehold. But he is not living there; he is using the house as an investment. We are therefore transposing one landlord for another. The intermediary head lessee now becomes the landlord.
>
> It is worse than that. When the head lessee acquires the right to enfranchise, the landlord does not receive any marriage value. The marriage value is automatically taken at the extension of a lease or when there is a sale to a tenant. So it is the current head lessee--who may not be a desirable person at the best of times--who is the beneficiary.[265]

Lord McIntosh was not certain that the Bill would have this effect but agreed to consider the position and introduce amendments if necessary.[266]

2. Exercising the right

Clause 118 would amend section 13 of the 1993 Act to require an initial notice to be given by a Right to Enfranchise (RTE) company consisting of the required number of qualifying tenants, rather than by the qualifying tenants themselves. Where there are only two qualifying tenants in a block, both would have to be members of the RTE company.

Clause 119 would insert new sections 4A, 4B and 4C into the 1993 Act. These clauses would define a RTE company (a private company limited by guarantee);[267] specify who may be a member of the company (all qualifying tenants and landlords where the company is also a RTM company) and provide a power to make regulations specifying the content of memorandum and articles of these companies. As with the use of a company limited by guarantee for the right to manage and commonhold associations,

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[262] HL Deb 22 October 2001 cc 858-9
[263] HL Deb 13 November 2001 cc 516-7
[264] Leaseholders, unless the lease specifically forbids it, can sublet their properties and delegate some of their rights over the property to someone else. Where this happens s/he is a head lessee.
[265] HL Deb 13 November 2001 c516-8
[266] HL Deb 13 November 2001 c 521
[267] ie the same corporate structure as that required for the right to manage and commonhold associations

discussion took place at all Lords stages of the first Bill over the appropriateness of this structure. Lord Goodhart moved an amendment to allow blocks with fewer than 10 flats to form a RTE company which would be a limited liability partnership.[268] Alternatively, Lord Hodgson of Astley Abbots argued for flexibility over the appropriate structure of the RTE company.[269] Lord Whitty, responding, rejected the option of flexibility on the grounds that the Government wished to prescribe the constitution of the enfranchising body to make life easier for leaseholders and ensure that the body is suitable for its purpose. He did not accept that limited liability partnerships would be an acceptable structure for smaller blocks but addressed the motivation behind Lord Goodhart's amendment:

> It is worth saying that for most smaller blocks, compliance with the requirements of company law would not be particularly onerous. We would expect company formation agents to provide standard RTE companies off the shelf. A current review of company law is likely to lead to further simplification of the rules and reporting requirements for small companies. There are plans for measures to reduce the probability of companies being struck off the register and, if that occurs, making it easier and cheaper for them to be restored.
>
> I am not as worried as the noble Lord, Lord Goodhart, apparently is about the burden of forming a company and, subject to any further consideration we may have together, I do not believe his solution is the right one.[270]

Government amendments to clause 119 were agreed in Grand Committee on the first Bill. One of the amendments would allow more than one RTE company to exist for the same premises provided that none had served a notice under section 13 of the 1993 Act to initiate enfranchisement. Once such a notice is served only the company serving the notice would be considered to be the RTE company for the premises as long as the notice remains in force. Lord Whitty explained in what circumstances two RTE companies might exist:

> The reasons for allowing the RTE company for the early stages in the enfranchisement process may vary. The most obvious is that the leaseholders might wish to do so because their existing RTE company is also an RTM company and they have now decided that they do not want to lose the right to manage by enfranchising through that company, and therefore wish to establish a new RTE company. It will not, however, be possible to have competing enfranchisement bids going on for the same property at the same time.[271]

During the Committee and Report stages of the current Bill Lord Goodhart moved amendments to clause 119 to provide that a RTM company should not be able to convert

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[268] HL Deb 15 March 2001 CWH 213-4
[269] HL Deb 15 March 2001 CWH 215
[270] HL Deb 15 March 2001 CWH 216-7
[271] HL Deb 15 March 2001 CWH 218

to a RTE company without the unanimous consent of all its members. The purpose of this amendment was "to ensure that the rights of those who want to continue to be involved in management but do not want to proceed to enfranchisement are preserved, whatever the views of other members of the company.[272] Lord Falconer, in rejecting the amendment, pointed out that non-participating leaseholders would still have the benefit of general rights under leasehold law.[273]

Lord Goodhart moved further amendments to clause 119 to tie the membership of a RTE company to the holding of a particular lease in the building. He said it was important to link membership of the RTE company to the leasehold rights in the property and that this would bring RTE companies in line with commonhold associations.[274] Lord Falconer explained what would happen in respect of RTE company membership on the assignment of a lease and why the Government could not approve the amendment:

> Company law does not provide for the automatic transfer of membership of a company limited by guarantee. Section 22 of the Companies Act 1985 sets two conditions which have to be satisfied to constitute a person as a member of such a company. First, the person must agree to become a member and, secondly, the member's name should be entered on the register. Both those conditions must be met and are cumulative. Unless both conditions are satisfied, the person in question will not have acquired the status of a member. The Government would be very reluctant to override that key principle in this particular case.
>
> As I explained, although Part 1 of the Bill, and regulations to be made under it, make provisions which are intended to ensure that all purchasers of commonhold units must agree to become members of the commonhold association, the situation with RTE companies is rather different. Unlike the commonhold association, where the Bill envisages ongoing regulation, we are proposing to regulate RTE companies only during the enfranchisement process.
>
> We consider that the operation of the company after enfranchisement should be a matter for the enfranchised leaseholders to agree among themselves. We do, however, agree that the RTE company should be able to admit new members after completion. This would include assignees of participating members or leaseholders who did not participate in the original enfranchisement. We accept that the draft of the memorandum and articles, which we provided to your Lordships, did not provide for that and we shall include appropriate changes in revised drafts which we expect to produce shortly.
>
> As we have said previously, in practice, where a participating member assigns his lease, the premium would reflect the benefits of membership. It is unlikely that the prospective assignee would agree to the purchase without being satisfied that membership of the RTE company was an integral part of the package. This

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[272] HL Deb 13 November 2001 c 521-2
[273] HL Deb 13 November 2001 cc 522-3
[274] HL Deb 22 October 2001 cc 523-4 & HL Deb 13 November 2001 cc 861-2

> happens now with both the existing nominee purchaser arrangements under the 1993 Act and in other circumstances where there is a leaseholders' management company and we are not aware of any problems.

Clause 120 would insert a new clause 12A into the 1993 Act to require the RTE company, before making a claim to exercise the RTE, to serve a "notice of invitation to participate" on all qualifying tenants in the block who had not yet agreed to be participating members. Fourteen days would have to elapse after the service of this notice before the right to enfranchise could be exercised. Under the current legislation, once the requisite majorities of qualifying tenants have been secured, the participating leaseholders can refuse to allow the others to join in.

An amendment moved in Grand Committee on the first Bill sought to make it possible for people wanting to form a RTE company to serve invitations to participate before forming the company with a view to testing the level of interest amongst qualifying tenants. Further amendments concerned the question of whether the notice should include an estimate of the costs of enfranchisement and whether a freeholder who is also a qualifying tenant should have access to these estimates. Lord Whitty, responding, thought that an informal consultation exercise prior to service of notices was inevitable and was not prevented by the Bill and that it was "fair and reasonable" for potential participants to have an estimate of the likely costs involved. He clarified that resident freeholders will not be qualifying tenants and so will not be served with a notice including estimated costs.[275]

Clause 121 would bring into effect **schedule 8** to the Bill. Schedule 8 would make consequential amendments principally to the *1993 Leasehold Reform, Housing and Urban Development Act.*

Clause 122 would extend a landlord's right of access for valuation purposes under section 17(1) of the 1993 Act so that it would apply for any purpose in connection with a claim to exercise the collective right of enfranchisement.

3. The purchase price

This is the area that leaseholders have found the most complex and contentious. The Department of Environment Transport and the Region's (DETR) analysis of responses to the draft Bill and consultation paper found "almost unanimous support" (95%) for the simplification of the valuation process.[276]

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[275] HL Deb 15 March 2001 CWH 223-5

[276] DETR, Analysis of responses to consultation on leasehold reform, January 2001, para 21

Clause 123 would amend **schedule 6** to the 1993 Act to provide that the various values included in the price payable by the RTE company shall be determined as at the "relevant date," ie the date of service of the initial notice instead of the "valuation date".[277]

In Committee and on Report Lord Kingsland expressed support for the proposal to fix the valuation date but moved an amendment to fix it at the date of service of the landlord's counter-notice on the ground that "this is the point at which the second party engages in the process'.[278] Lord Kingsland also moved an amendment to incorporate interest at the current bank base rate into the purchase price; he argued that if the valuation date is fixed at the date of claim, leaseholders would have an interest in delaying the conclusion of the purchase. Lord Falconer's response referred to support for the Government's position (on the valuation date) from 93% of those who commented on this proposal during the consultation process. He was concerned that aligning the valuation date with the date of the counter-notice would give the landlord a further reason to delay service during periods of rising property prices. On the question of interest, Lord Falconer appreciated that landlords could be disadvantaged in a rising property market but did not think it would be fair to give a right to a payment of interest on the purchase price between the date used to determine the price and completion.[279] On Report Lord Kingsland's amendment was negatived on a division.[280]

The basis for determining the price payable for a freehold under the 1993 Act is, in outline, the aggregate of three components:

- the open market value of the freeholder's interest in the premises;
- the freeholder's share of the 'marriage value'[281] (which must be at least 50% of it but may be more if the parties so agree or a LVT so determines). In the case of collective enfranchisement marriage value is the additional value created by the ability of the participating leaseholders to have new very long leases granted to them without payment of a premium; and
- any compensation for losses (for example, loss of development value) resulting from the enfranchisement.

Clause 124 would amend paragraph 4(1) of schedule 6 to the 1993 Act to provide that the freeholder's share of the marriage value should be 50% in all cases. **Clause 125** would amend paragraph 4 of schedule 6 to provide that where the unexpired term of each of the

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277 The valuation date is the date on which it is agreed or determined what freehold interests will be acquired by the company.

278 HL Deb 22 October 2001 cc 865-6

279 HL Deb 22 October 2001 cc 866-7

280 HL Deb 13 November 2001 cc 526-7

281 Marriage value arises because the value of a lease and the value of a reversion, if sold separately, is usually less than the value of the same property if sold with vacant possession. The merger of the lease and the reversion produces a boost in value known as the marriage value.

leases held by participating members of the company exceeds 80 years, at the relevant date, the marriage value will be treated as nil.[282]

Marriage value has proved to be one of the most controversial aspects of the 1993 Act. Just under 64% of respondents to the 1998 consultation paper, the vast majority of them leaseholders, said that marriage value should be abolished altogether:

> Landlords who developed the block themselves have already sold the leases at full market value; through 'marriage value' they seek to be paid again for something they have already sold. In the case of landlords who were not the developers and who bought the freehold on the open market or at auction. CARL would argue that there is no justification whatsoever for them to demand (and to receive) obscenely huge returns on their investment at the expense of lessees.[283]

The next most favoured option was for marriage value to be apportioned equally between the parties in all cases.[284]

In Committee, on Report, and at Third Reading Lord Goodhart moved a group of amendments to provide that marriage value should be disregarded in the case of collective enfranchisement, individual enfranchisement of leasehold houses[285] and also in the case of granting an extended lease. When moving the same amendments during the Lords stages of the first Bill he said:

> We believe that marriage value should go: it is complicated and unfair. We believe that the landlord is adequately compensated by being paid the market value of the property that he loses as a result of the enfranchisement, or the extended lease, without increasing what he receives by taking into account the position of the tenant as a prospective special purchaser. This is particularly so in relation to extended leases where the concept of marriage value is an artificial absurdity. Even with the modest simplification proposed by the Government, the computation of marriage value will add to the expense and time of working out the terms of enfranchisement, or the price of an extended lease.[286]

Alternatively, Lord Kingsland argued that marriage value is an accepted part of the property scene and that its abolition would change attitudes (presumably amongst property owners) towards the Bill. Lord Kingsland spoke to amendments that would have left the marriage value provisions in the 1993 Act unchanged. He also supported the deletion of clause 125 or a return to the 90 year barrier for marriage value (proposed in

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[282] In the draft Bill and consultation document the Government had suggested that the marriage value should be treated as nil where the unexpired term was above 90 years.

[283] CARL's response to *Residential Leasehold Reform in England and Wales,* March 1999, p 7

[284] Cm 4843 paras 14-15

[285] This process is governed by the *1967 Leasehold Reform Act.*

[286] HL Deb 15 March 2001 CWH 230

the draft Bill) on the basis that marriage value does exist in London on leases with terms of over 80 years.[287]

Responding to Lord Goodhart's proposed amendments, Lord Falconer gave a detailed explanation of the concept of marriage value and why it has been applied (or not) in various circumstances.[288] He defended the levying of marriage value and drew comparisons with the compulsory acquisition of a freehold by leaseholders under Part III of the *1987 Landlord and Tenant Act* when a landlord is in serious breach of the lease. Lord Falconer pointed out that in these circumstances there is no allowance for marriage value in the price and argued that to disregard it for "no-fault" enfranchisement under the 1993 Act would be "difficult to defend".[289]

On the cut-off point for calculating marriage value Lord Falconer said:

> We have already heard different views on the principle of the cut-off and the level at which it should be set. Our objective is to prevent costly arguments that are disproportionate to the sums at stake. The principle of a cut-off is consistent with that objective and we are committed to it. Whatever cut-off is chosen, it seems likely that there will be those who will argue that it should be raised or lowered and an element of compromise is needed.
>
> We accept that LVTs have sometimes awarded an element of marriage value when leases have 90 or more years unexpired. However, it would normally be a relatively small amount of money. We also need to consider the point made to us by a number of professionals with long experience in the field that before the 1993 Act came into force, flats with very long leases did not command a measurably higher price than those with unexpired leases of 80 years. That shows that at that time leaseholders would place no additional value on the ability to obtain a new, longer lease.
>
> One key principle of the 1993 Act was that valuations for collective enfranchisement would be on the assumption that the Act did not exist, but in practice the Act's operation has distorted the market so that transactions have taken place including an element of marriage value where the unexpired terms of the existing leases exceeded 80 years. That effect has been assisted by the fact that some very experienced and well resourced landlords, particularly on the great London estates, have brought to bear in these transactions the best professional advice that money can buy, often leaving the leaseholders somewhat outgunned. The Government's proposals would restore the original objective of a "no 1993 Act world" to the valuation process. We believe that the 80-year cut-off achieves that.[290]

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[287] HL Deb 22 October 2001 cc 870-1
[288] HL Deb 22 October 2001 cc 871-2
[289] HL Deb 22 October 2001 c 873
[290] HL Deb 22 October 2001 c 874

Lord Goodhart's amendments were negatived on a division during Third Reading.[291]

The 1998 consultation paper discussed the possibility of prescribing values for some of the variables that regularly enter the valuation process, such as yield[292] and relativities.[293] The draft Bill did not include such provisions but asked for further comments. Respondents expressed some concern that proposals to fix the discount rates or 'yields' would interfere with the impartiality of the system and the guarantee that the freeholder would receive "full and adequate compensation for the enforced loss of his interest."[294] LEASE fully supported the principle of prescription of variables:

> The report on Relative Values from the College of Estate Management (August 2000) concludes that prescription of both (yield and relativity) are possible although reserving the need for further research. We strongly recommend that the Bill contain enabling provisions for the Minister to be able to presume yields and relativities from time to time, pending further consideration of the details.[295]

The British Property Federation (BPF) was less confident that yield rates and relative values could be prescribed fairly:

> We have concluded that the only means by which this could be achieved fairly would involve introducing further levels of complexity into the legislation. It is argued that the impact on the owners of portfolios will ultimately balance out; this will be of little comfort to the single freeholder, or indeed leaseholder, who finds himself on the swing when he would have done better on the roundabout.[296]

The BPF supported more research into this area. The current Bill makes no provision in relation to the prescription of variables.

D. New leases for tenants of flats (clauses 126-133)

Most leasehold flat owners have an individual right under the *1993 Leasehold Reform, Housing and Urban Development Act* to acquire a new lease that adds 90 years to the term remaining on the original lease. This provides an alternative to collective enfranchisement and in cases where enfranchisement cannot be exercised, eg where there is not enough support for enfranchisement, it is the only available solution to the "wasting asset" problem.

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[291] HL Deb 19 November 2001 924-5

[292] When a property is valued the right to receive money, or the obligation to make payments, is discounted to give its present value at an appropriate rate (also known as the capitalisation rate or yield).

[293] This refers to the relative values of individual flats.

[294] BPF's response to the draft Bill, para 27

[295] LEASE response to draft Bill, para 2.8(d)

[296] BPF's response to the draft Bill, para 37

The provisions in Chapter 3 of the Bill are aimed at relaxing the rules governing the right of tenants to acquire new leases under the 1993 Act. **Clause 126** would provide that the Chapter would amend the rights of tenants to acquire new leases under the 1993 Act.

1. The qualifying rules

Clause 127 would replace the existing residence test. Currently this test provides that when a leaseholder serves notice to buy a new lease they must have occupied the flat as their only or main home for:

- the last three years; or
- periods that add up to 3 years in the last 10.

The new test would only require that the tenant must have been a qualifying tenant (long leaseholder) for at least two years before exercising the right to lease renewal.

During the consultation process leaseholder groups expressed "strong" support for relaxing the qualifying rules for individual tenants to extend their lease agreements;[297] however, the Leasehold Advisory Service did not agree with the proposal to replace the residence test:

> This effectively only improves the situation for tenants by one year and, in the light of the removal of the residence qualification for collective enfranchisement, we fail to see the justification of the test. The switch from prior residence to prior ownership will do nothing to improve the position of tenants buying a short lease flat, it will still be an obstacle to mortgagability.[298]

In Committee Lord Kingsland moved amendments to clause 127 with the aim of retaining the residence test.[299] He thought there was a need to retain a residence condition in order to prevent "undesirable speculation" from property investors. In response, Lord McIntosh set out the Government's reasons for abolishing the residence test:

> However, in the Government's view, it is impossible to devise a fair, workable and unambiguous qualifying test that relies on such a slippery concept as residence. As we have already explained in the context of the right to manage and collective enfranchisement, when considering eligibility for leaseholders' rights we believe that the key principle should be the extent of their stake in the property rather than their length of residence. Residence requirements, however expressed, are open to manipulation and abuse and to endless arguments over interpretation, which we wish to avoid. We are not convinced that tinkering with the residence requirements will overcome those difficulties, and we propose to

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297 DETR, January 2001, para 3.1
298 LEASE response to the draft Bill, para 3.2
299 HL Deb 22 October 2001 cc 875-7

> maintain the position set out in the Bill, which abolishes all residence requirements.
>
> Of course, there is one qualification which I neglected to mention earlier; that is, the need to avoid opportunities for short-term speculative gain. Therefore, instead of the residence test, the Bill provides an alternative requirement of extreme simplicity: the leaseholder must have held a long lease for at least two years before he or she can exercise the individual rights of lease renewal for flats and enfranchisement of houses. We consider that to be a sensible balance.[300]

Clause 128 would amend the definition of a qualifying tenant for lease renewal. Currently a qualifying tenant must either have a lease of more than 35 years or a lease of more than 21 years at a low rent. These restrictions would be removed and a qualifying tenant for this purpose would simply be a long leaseholder of a flat, ie the holder of a lease originally granted for over 21 years.

Clause 128 would provide that where a deceased tenant had been a qualifying tenant for at least 2 years (see clause 127), their personal representatives would have the right to a new lease. This right would have to be exercised within one year[301] starting from the grant of probate or letters of administration. The consultation process revealed general support for proposals concerning the personal representatives of deceased leaseholders, although 44% of responding freeholders disagreed with the proposals.[302]

Clause 130 would insert a new version of section 94(2) of the 1993 Act to ensure that any long leaseholder of a flat in Crown property will be able to obtain a new lease where their immediate landlord is not the Crown. Where the Crown is the immediate landlord the long leaseholder will be able to obtain a new lease outside the 1993 Act under a voluntary undertaking given by the Crown to that effect. Exceptions that would apply to the Crown include:

- where a property stands on inalienable land which is defined by the *Windsor Estate Act 1961;*and
- where property or land has a long historic or particular association with the Crown, eg the garrison at St Mary's on the Isle of Scilly.

At Third Reading Lord Kingsland suggested that these exemptions might conflict with the *1998 Human Rights Act* on the ground that they violate the right to property under Protocol 1, Article 1 of the European Convention on Human Rights (ECHR).[303] In response, Lord Falconer gave a detailed account of how the undertaking by the Crown

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[300] HL Deb 22 October 2001 cc 877-9

[301] This period of time was initially six months but was extended to one year at Report stage (HL Deb 13 November 2001 c 546)

[302] DETR, January 2001, para 3.6

[303] HL Deb 19 November 2001 c 926

operates. He expressed the view that the existing arrangements did not give rise to any problems of ECHR compliance and pointed out that legislation already provides for a number of exemptions, for example in designated rural areas.[304]

2. The purchase price

Clause 131 would provide that the determination of the various values included in the price payable by the tenant under schedule 13 to the 1993 Act would be as at the "relevant date", ie the date of the service of the initial notice under section 39 of that Act. This would bring the valuation date for lease renewal in line with that for collective enfranchisement (clause 123).

Clause 132 would provide for the freeholder's share of the marriage value to be 50% in all cases. **Clause 133** would provide for the disregard of marriage value where the unexpired term of the lease exceeds 80 years at the relevant date. These are parallel provisions to clauses 124 and 125 for collective enfranchisement (see pages 79-82).

E. Leasehold houses (clauses 134-146)

During the consultation exercise the proposals in respect of leasehold houses proved to be relatively uncontroversial. There was agreement amongst leaseholder and landlord groups that leasehold house owners should be able to enfranchise after having extended their lease agreements and that they should also benefit from security of tenure on the expiry of the extended term. However, a majority of leaseholders did not agree with the proposal that leaseholders of houses, who enfranchise after the expiry of the original term of the lease, should pay an open market price including marriage value.[305]

1. The rights

Most owners of leasehold houses have had the right to buy the freehold of their homes or extend their leases by 50 years since the enactment of the *1967 Leasehold Reform Act.* The right to extend can only be exercised once and when the expiry date of the original lease has passed the right to enfranchise is lost.

Clause 134 would provide for amendments to the *1967 Leasehold Reform Act.*

Clause 135 would amend section 1 of the 1967 Act to abolish the residence test as it applies to leasehold houses. This would bring the rules on enfranchisement of houses in line with those for collective enfranchisement of blocks of flats. It would also provide that where a person has a superior lease[306] to a qualifying tenant, the superior leaseholder

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304 HL Deb 19 November 2001 cc 926-8

305 DETR, January 2001, para 4.3

306 eg the head lessee with a lease for a longer term than that of the qualifying tenant

would not have the right to enfranchise and/or extend the lease. Only considerations of space prevented this clause from being included in the first Bill.[307]

Clause 136 would introduce a requirement for the leaseholder to have held his or her lease for at least two years before exercising the right to enfranchise or extend their lease. The clause would also exclude leaseholders from these rights if their tenancy of the house was a business tenancy *unless* they could pass a residence test. The test would involve occupying the house as their only or main residence for the last two years or periods amounting to at least two years in the last ten.

At Third Reading the Earl of Caithness returned to the question of head lessees gaining new rights through the abolition of the residence test to "expropriate the properties of existing landlords and benefit from any marriage value in future transactions."[308] On this occasion Lord Falconer agreed that the Bill could be interpreted in a way that would allow head lessees to make windfall gains. He advised that changes were being considered and that an amendment would be introduced in "another place" to close this loophole.[309]

Clause 137 would exclude business tenants[310] from the right to enfranchise unless they were originally granted a lease with at least 35 years to run, or the lease contained a covenant or obligation for renewal that had been exercised to make the total term more than 35 years. This clause was inserted by the Government on Report.[311]

Clause 138 would amend section 1AA of the 1967 Act to extend the right to enfranchise to leaseholders of houses who were originally granted leases for more than 21 years but less than 35 years and who are unable to pass the relevant low rent test. It would make consequential amendments to the rural exemptions to enfranchisement.[312]

During debates on the first Bill the Government said it was not inclined to revisit the question of leasehold houses excluded from enfranchisement in designated rural areas and agreed to consider the case for amending the rural exemption to achieve better targeting in the longer term.[313] The matter was raised again during the Committee stage of the current Bill and again Lord McIntosh expressed sympathy with a new clause moved by Lord Goodhart but could not promise to resolve the matter in the context of this Bill.[314]

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307 HL Deb 22 March 2001 CWH 248
308 HL Deb 19 November 2001 c 931
309 HL Deb 19 November 2001 c 932
310 Who must also meet the residence test in clause 136
311 HL Deb 13 November 2001 c 547
312 Section 1AA of the 1967 Act exempts from enfranchisement certain properties held on a long lease at a low rent in areas designated as rural areas by the Secretary of State. The purpose of the exemption is to prevent the break-up of country estates.
313 HL Deb 22 March 2001 CWH 250
314 HL Deb 22 October 2001 cc 879-80

Clause 139 would amend section 6 of the 1967 Act to improve the rights of those who inherit leasehold houses to exercise the right to enfranchise within a certain time period.

Clause 140 would amend section 16 of the 1967 Act to allow leaseholders with extended leases, and also sub-tenants of tenants with extended leases, the right to acquire a freehold interest if otherwise qualified to do so. This provision would be retrospective.

Currently leaseholders of houses who do not extend their lease before the expiry of the original term have a right to remain in occupation as assured tenants when the long lease expires.[315] This right is lost if they extend the lease with the result that there is no security of tenure when the lease extension ends. In these cases the value of the asset declines rapidly and the ex-leaseholder faces eviction. Subsection 2 of clause 140 would replace section 16(1B) of the 1967 Act and replace it with a provision to allow those with extended leases to benefit from security of tenure even if they cannot meet the relevant low rent test.

Clause 141 would correct technical defects in the 1967 Act relating to shared ownership properties. During debates on the first Bill Lord McIntosh gave a commitment to find a form of words that would ensure that shared ownership houses could only be acquired by shared owners through a process of staircasing; that is, gradually increasing their share in the property eventually to 100%. Barroness Maddock had pointed out that loopholes in the current legislation enabled shared owners to enfranchise from social landlords for very small sums of money.[316]

2. The purchase price

Clause 142 would provide that, where relevant, marriage value on a house should be split equally between leaseholder and landlord.[317]

Clause 143 would provide for marriage value to be disregarded where the lease on a house has more than 80 years to run.

Clause 144 would provide that where a leaseholder gains the right to enfranchise by virtue of clause 139 (ie those who inherit a leasehold property) s/he will pay a price that includes a share of the marriage value, where relevant.

3. Absent landlords

Clause 145 would amend section 27 of the 1967 Act. Currently section 27 confers powers on the High Court in cases where a leaseholder of a house wishes to enfranchise but cannot trace the freeholder. The leaseholder must apply to the High Court for a

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315 Section 186 and Schedule 10 to the *Local Government and Housing Act 1989*

316 HL Deb 22 March 2001 CWH 252-3

317 See footnote 281 for a definition of marriage value.

vesting order; once granted the Lands Tribunal appoints a surveyor to value the freehold interest. Leaseholders of houses have found this procedure to be burdensome. The Bill would transfer jurisdiction to the county court and allow this court to issue a vesting order to enable the freehold to be bought in the absence of the freeholder where the court is satisfied that certain conditions are met. The price paid would be paid to the county court rather than the Supreme Court.

Clause 146 would replace section 27(5) of the 1967 Act with a new section and would also amend section 21(1) of that Act. The effect would be to transfer jurisdiction to determine the price to be paid for the freehold where the landlord cannot be traced from the President of the Lands Tribunal to a leasehold valuation tribunal.

F. Other provisions in leases (clauses 147-163)

1. Service and administration charges

Leaseholders enjoy a range of existing rights under the *1985 Landlord and Tenant Act* (as amended) in relation to service charges.[318] Problems have been identified with these rights, for example:

- The rights granted by the 1985 Act only apply in relation to service charges within the meaning of that Act. This covers charges payable for services, repairs, maintenance or insurance or the landlord's management costs. Charges that fall outside this definition include the cost of improvements to a property and charges for obtaining a landlord's consent to structural works.

- The requirement to consult leaseholders before carrying out major works depends on whether the costs exceed a threshold of £50 x the number of dwellings let to leaseholders who are required to pay service charges or £1,000, whichever is the higher. This formula means that the amount of money that individual leaseholders may be required to pay without prior consultation varies considerably. A further problem is that the consultation is limited to "works." Some landlords place long term contracts to handle all maintenance work as and when necessary. This makes the consultation requirement difficult to enforce.

- The limitation of the jurisdiction of leasehold valuation tribunals (LVTs) to questions about the standard and cost of services or works means that landlords or leaseholders may need to go to both court *and* the LVT to resolve certain disputes.

In the draft Bill and consultation document the Government set out its objectives in relation to service charges:

[318] see http://hcl1.hclibrary.parliament.uk/notes/sps/leasereform.pdf

> We wish to ensure that existing rights in relation to service charges (e.g. the right to apply to a LVT for a determination of reasonableness) apply, where relevant, to any variable charge which is required to be paid as a condition of a lease. We also intend to strengthen and simplify the existing requirements on landlords to consult leaseholders and to transfer jurisdiction for resolving disputes about compliance from the county court to LVTs.[319]

Clause 147 would give effect to **schedule 9**. Schedule 9 would apply existing provisions relating to the management of, and service charges in respect of, leasehold properties to cover improvements and any other matters that may be specified by order.

During the consultation process the DETR (now DTLR) found wide disagreement amongst leaseholder respondents to the proposed amendment to the definition of service charges under the 1985 Act to include charges payable for improvements. A possible explanation for this is that leaseholders misunderstood the Government's intentions and concluded that extending the definition of service charges would mean that there would be more items on which a charge would be payable.[320] This might also explain leaseholders' rejection of the proposal to extend local authorities and registered social landlords' power to issue loans to cover the cost of improvements.[321] The landlord lobby was not convinced that this proposal would assist the situation. The Association of Residential Managing Agent's (ARMA) response called for a clear definition of an "improvement" if such an amendment was to be made.[322]

In Grand Committee on the first Bill Lord Richard moved an amendment to extend schedule 9 to cover charges arising from Estate Management Schemes.[323] An Estate Management Scheme is a scheme approved by a leasehold valuation tribunal for an area occupied directly or indirectly under leases held under one landlord. The purpose of these schemes, which can be set up under section 19 of the *1967 Leasehold Reform Act* or sections 69-75 of the *1993 Leasehold Reform, Housing and Urban Development Act,* is to prevent wholesale enfranchisement from damaging or destroying the character of estates held by one landlord. Jurisdiction for varying the terms of these schemes lies with the leasehold valuation tribunal but the charges payable under such schemes are not subject to the same statutory controls that apply to the payment of other service charges.[324]

This matter was raised again by Baroness Gardner of Parkes during the Report stage of the current Bill. In response Lord Falconer agreed that the lack of statutory controls over

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319 Cm 4843, p 164
320 DETR, *Analysis of responses to the consultation paper on Leasehold Reform,* January 2001, p 32
321 ibid p 33
322 ARMA's response to the draft Bill
323 HL Deb 22 March 2001 CWH 254
324 Under the *1985 Landlord & Tenant Act* (as amended)

charges for Estate Management Schemes was an anomaly; however, he could not promise that space would be found in the current Bill to resolve this.[325]

Clause 148 would substitute a new section for section 20 of the 1985 Act which requires landlords to consult with tenants before carrying out works to which a tenant is obliged to contribute through a service charge, and restricts their right to recover costs if they fail to do so. Landlords would be required to consult (before carrying out works) where the cost payable by any service charge payer for specific works exceeds a set amount (to be prescribed in regulations). A consultation requirement would also apply where a landlord proposed to enter into a long-term contract (defined as a term of more than 12 months) for the provision of services. Failure to comply would result in all the costs incurred being irrecoverable. Detailed provisions on the consultation procedure and exempt agreements would be set out in regulations.[326]

The consultation process revealed "in principle" support for strengthening the existing requirements to consult with leaseholders over management and maintenance issues. ARMA was concerned that an increased requirement to consult might result in disproportionate costs and suggested some alternative ways in which consultation could be carried out.[327] Both ARMA and the British Property Federation (BPF) agreed that the financial limits that currently prompt consultation were due for revision. There was a sharp divide between leaseholders and other respondent types over whether leaseholders' liability to pay towards work where the consultation requirement is not met should be limited to a specified sum.[328]

Clause 149 would substitute a new section for section 21 of the 1985 Act. This section currently gives tenants the right to request a summary of the costs on which their service charge is based. The new section 21 would require landlords to provide annual accounting statements, the form and content of which would be prescribed by regulation. These statements would have to be certified by a qualified accountant, except where exempted. Landlords would also have to provide leaseholders with a summary of their rights and obligations in relation to service charges. Statements would have to be provided no later than six months after the end of an accounting period.

Clause 149 would also introduce a new section 21A under which tenants would be able to withhold payments where landlords fail to provide documents which exactly or substantially meet the relevant requirements.

Clause 150 would substitute a new section for section 22 for the 1985 Act. Section 22 currently allows tenants to inspect documentation which supports a summary of costs.

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325 HL Deb 13 November 2001 c 552

326 The DTLR is currently consulting over the revised procedures for consulting leaseholders on major works. A discussion paper was issued in November 2001 and consultation closes on 11 January 2002.

327 ARMA's response to the draft Bill

328 DETR, *Analysis of responses to the consultation paper on Leasehold Reform*, January 2001, p 34

The new section would give tenants the right to inspect documentation relevant to their accounting statements within 21 days of request.

Clause 151 would insert a new section 27A into the 1985 Act to provide that landlords or tenants may apply to a leasehold valuation tribunal (LVT) for a determination on whether service charges are payable and, if they are payable, by whom they are payable, the amount payable, the date payable and the manner in which they are payable. Landlords and tenants would be able to apply before the relevant costs are incurred.

These provisions would replace and extend the existing provisions under section 19(2A) to (3) of the 1985 Act[329] which enable LVTs to determine the reasonableness of service charges. The provision that prevented LVTs from hearing disputes where leases contained an arbitration clause would be removed; arbitration agreements would be void unless arbitration is agreed to after a particular dispute has arisen.

Clause 152 would insert a new section 42A into the *1987 Landlord and Tenant Act.* This would require payees[330] to hold service charge funds from separate groups of service charge payer in separate accounts. These provisions would not apply to local authority landlords and registered social landlords, amongst others.[331] The new section 42A would require payees to notify the relevant financial institution, in writing, that sums standing to the credit of a trust fund would be held in it. Tenants would have the right to ask for proof that the relevant requirements had been complied with. Failure to comply with section 42A would be a criminal offence.

The consultation paper of November 1998 sought views on how the Government might ensure more effective protection for the monies that leaseholders pay into service charge accounts and sinking funds. Support was forthcoming for the suggestion that separate service charge accounts should be maintained for each property, or group of properties, for which there are common service charges. In addition, more than 100 of the 956 respondents raised general concerns relating to the accounting regime. These provisions were not included in the first Bill.

Clause 153 would give effect to **schedule 10** to the Bill. The Explanatory Notes describe schedule 10 as making a number of minor consequential amendments.[332]

Clause 154 would give effect to **schedule 11** to the Bill. Schedule 11 would define an administration charge as a variable charge payable for approvals required as a condition of a lease, for the provision of information to leaseholders or others (eg prospective purchasers), penalty charges for late payment of rent or other charges, or charges in

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329 These would be repealed by schedule 14 to the Bill.

330 Defined as the landlord or other person to whom any such charges are payable under the terms of their leases (section 42 of the 1987 Act).

331 Exempt landlords are listed in section 58(1) of the 1987 Act.

332 HL Bill 51-EN para 262

connection with a breach of a covenant or condition of a lease. These charges would only be payable to the extent that they are reasonable and LVTs will have jurisdiction to determine the question of reasonableness. This clause represents a significant development as it brings within regulation a whole raft of charges that freeholders regularly levy against leaseholders.

2. The appointment of a manager

Clause 155 would enable leaseholders to apply to a leasehold valuation tribunal for the appointment of a manager under Part 2 of the 1987 Act where their lease provides for management functions to be carried out by a third party manager. This would correct a defect in the current procedures.

Clause 156 would enable leaseholders in converted properties with a resident landlord to apply for the appointment of a manager if at least half the flats in the building are held on long leases which are not business tenancies under Part 2 of the *Landlord and Tenant Act 1954.* These leaseholders are currently exempt from the appointment of a manager provisions but it is recognised that resident landlords' standards of management may not always be acceptable.

3. Lease variations

The draft Bill and consultation paper set out the Government's intention to clarify the existing grounds on which a lease may be varied, extend the grounds on which an application for a variation may be made and reduce the costs and length of time involved in variation applications by transferring jurisdiction to LVTs. The consultation paper recognised that a number of existing leases were defective and that the procedure to vary leases under the *1987 Landlord and Tenant Act* was long winded and expensive:

> The management-related provisions of a lease can frequently be defective in a number of ways. Leases may fail to make provision for important functions, such as the insurance of the building. More commonly, the provisions of a lease may be ambiguous and/or poorly drafted, making management of the building very difficult. Defects may also range across a number of leases – for example, where the apportionment of service charge percentages between the leaseholders in a block does not total 100%. Inadequate provisions can also cause problems at the time a leaseholder is seeking to sell his or her flat, particularly if a lender is reluctant to grant a mortgage unless a defect in the lease is remedied.[333]

Provisions in the consultation paper did not make their way into the first Bill but are included in the current Bill. **Clause 157** would extend and clarify the grounds for applying for a lease variation under section 35 of the 1987 Act. New sub-section (2)(b) of section 35 would make it clear that a lease of a flat that does not require the building as a

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[333] Cm 4843, p 180

whole to be insured under a single policy would not have made satisfactory provision for insurance. **Clause 158** would transfer jurisdiction for lease variations to LVTs from the county court.

4. Ground rent

Most long residential leases require ground rent to be paid on a particular day irrespective of whether or not the landlord demands payment. The 1998 consultation paper noted that there was evidence of a number of landlords not bothering to ask for payment and then, when leaseholders forget to pay by the due date, demanding additional charges or instituting forfeiture procedures.

Clause 159 would provide that a long leaseholder is not liable to pay ground rent unless the landlord has issued a notice in accordance with the requirements of the clause.

During the consultation process respondents in the property industry expressed concern that problems might occur over the interpretation of what constitutes a proper demand for ground rent. ARMA questioned why a contractual agreement to pay ground rent was not a sufficient basis for claiming payment.[334] The cost of issuing demands was also raised in responses. A high proportion of the leaseholders that responded to the consultation paper agreed with the proposals in regard to ground rent.[335]

5. Forfeiture

Most long residential leases enable the landlord to forfeit the lease (ie to re-enter and take possession of the property) if the leaseholder fails to comply with any of its terms. Forfeiture is recognised to be a draconian penalty in so far as a home can, in theory, be lost because of a debt of a few pounds. In practice, forfeiture rarely occurs. Existing legislation provides a range of measures to protect leaseholders but there is concern that unscrupulous landlords use the threat of forfeiture to secure the payment of unreasonable charges for relatively minor breaches of covenant.

Clause 160 would place restrictions on the service of notices under section 146(1) of the *Law of Property Act 1925* in respect of breaches of covenants or conditions in a long lease. **Clause 161** would contain supplementary provisions to clause 160. **Clause 162** would amend section 81 of the *1996 Housing Act* which places restrictions on forfeiture for the non-payment of service charges.

In their consultation responses ARMA and the BPF accepted that forfeiture is an inequitable right that could provide a landlord with a substantial gain, but their responses emphasised the need for landlords to have an effective remedy for breaches of covenant.

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[334] ARMA's response to the draft Bill

[335] DETR, *Analysis of responses to the consultation paper on Leasehold Reform*, January 2001, p 50

The BPF said it would support the introduction of a minimum level of arrears and/or a minimum time period for which arrears must be outstanding before proceedings could be taken.[336] A suggestion put forward by the BPF was for a series of actions to be developed to give property managers the ability to take quick and effective action to enforce covenants in a lease.[337] ARMA and the Royal Institute of Chartered Surveyors (RICS) suggested the introduction of a concept of "forced sale" that would allow both the landlord to recover his/her full entitlement for breaches of contractual obligations, but which would allow the leaseholder to remain in possession of the (balance) of the equity.[338]

The DETR's analysis of responses to the draft Bill and consultation paper found that there was a clear trend in the answers given to indicate that the majority of leaseholders agreed with the forfeiture proposals while freeholders showed "less enthusiasm".[339]

6. Application to the Crown

Clause 163 would apply various provisions of the 1985, 1987, 1993 Acts and the *Housing Act 1996* relating to payment and holding of service charges to the Crown Estate, Duchies of Cornwall and Lancaster and Government departments. It would also apply new provisions on administration charges, ground rent and forfeiture of leases to those authorities.

G. Leasehold valuation tribunals (clauses 164-167)

The consultation process revealed an overwhelming dissatisfaction with the functioning of LVTs, primarily because leaseholders were encountering delays of between six months to one year in obtaining LVT hearings.

Chapter 6 of the Bill would consolidate and amend existing provisions relating to the jurisdiction and procedures of LVTs. **Clause 164** would provide for a rent assessment committee, constituted in accordance with schedule 10 to the *Rent Act 1977*, to carry out any functions conferred on a LVT under any legislative provisions. A committee performing such functions would be known as a LVT.

Clause 165 would give effect to **schedule 12** which would set out the LVT procedures. **Clause 166** would provide for appeals against LVT decisions to the Lands Tribunal and **clause 167** would give effect to **schedule 13** which would make a number of minor and consequential amendments to LVT provisions.

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336 BPF's response to the draft Bill, para 108
337 *ibid* para 110
338 ARMA's response to the draft Bill
339 DETR, *Analysis of responses to the consultation paper on Leasehold Reform,* January 2001, p 51

In all cases an appeal to the Lands Tribunal will only be allowed where permission has been obtained from the LVT in the first instance, or if refused, from the Lands Tribunal. The ending of the unfettered right to appeal to the Lands Tribunal against a decision of a LVT reflects the Government's belief that a minority of unscrupulous landlords have been exploiting this right in order to delay proceedings.

Paragraph 8 of schedule 12 would allow for the determination of LVT applications without an oral hearing. In Grand Committee on the first Bill Lord McIntosh explained that this route would be aimed at simple cases involving small sums with a view to keeping costs down. However, parties who insist on a full hearing will be able to do so provided they meet the cost of the hearing.[340]

Paragraph 10 of schedule 12 would, for the first time, provide LVTs with powers to award costs (up to a maximum of £500) on certain grounds (the grounds are set out in paragraph 7) or where a party has acted unreasonably during the proceedings. In Committee Lord Kingsland questioned whether £500 would be an adequate deterrent to wealthy parties and argued that LVTs should be able to award costs "at such a level as they think fit up to the amount incurred by the innocent party".[341]

In Committee and on Report Baroness Parkes moved an amendment to limit Lands Tribunal charges and to keep them in line with those of LVTs. She thought people were being put off from pursuing appeals because of the costs involved. Lord Falconer, responding, referred to Sir Andrew Leggatt's review of the tribunal system. The Government is consulting on the outcome of that review which will "provide an opportunity to consider all aspects of Lands Tribunal procedures, including its cost regimes."[342]

During the consultation process landlord and tenant groups agreed that the right of appeal to the Lands Tribunal should be subject to the leave of the LVT or Tribunal itself. There was general agreement on the need to resolve problems with the LVT system. The ARMA response to the draft Bill noted: "unless the speed and consistency of the LVT process is dramatically improved many of the reforms could founder and indeed leave everyone in a retrograde situation."[343]

III Issues not covered by the Bill

Several issues were raised during the consultation process that have not found their way into the Bill. This section of the paper outlines the main outstanding issues.

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340 HL Deb 22 March 2001 CWH 282-3
341 HL Deb 22 October 2001 c 888
342 HL Deb 13 November 2001 cc 553-4
343 para 6

A. The regulation of managing agents

The DETR's analysis of responses to the 1998 consultation paper noted that 96% of responses on this issue agreed that additional controls over managing agents were required.[344] LEASE is in favour of regulating the management of residential property and the introduction of a requirement that managers be licensed/registered.[345] Self-regulation is rejected as an option by leaseholder groups while ARMA has made the point that regulations, standards and controls should apply to all managers, including local authorities and registered social landlords.

ARMA agrees that standards of management in some leasehold blocks should be raised and would support increased regulation of agencies as long as it is not overly burdensome and does not interfere with the operation of reputable managing agents. ARMA has pointed out that the key issue is effective enforcement of any regulations that may be introduced.[346]

On Report and at Third Reading Lord Williams of Elvel moved an amendment to provide for the establishment of a professional regulatory body for property managers, or a licensing scheme, or other arrangements "deemed appropriate" by regulation (after consultation).[347] Lord Falconer set out the Government's position:

> We believe that the right course is to proceed with consultation, as we promised we would, on how to deal with this issue. If the consultation leads to the conclusion that we should legislate, then we should bring forward legislation in the first available legislative vehicle that would allow us to do so. We should use our best endeavours to seek to achieve that as soon as the legislative timetable allowed. Obviously, I am not in a position to say when that would be. We should hope that it would be in the next Session, but plainly that would depend on a whole range of unpredictable issues on which I am not in a position to comment.[348]

B. Insurance arrangements

Under the terms of most lease agreements there is a requirement for the lessee to insure the leased premises. More often that not the requirement is that it should be with an insurance company named by the landlord or through the landlord's agency. Failure to comply with this provision can lead to threats of, or actual, action for forfeiture. Lessees may challenge a landlord's choice of insurer only on the grounds that the insurance cover is unsatisfactory or the premiums payable are excessive. Leaseholders often resent the

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344 DETR *An Analysis of Responses to 'Residential Leasehold Reform in England and Wales – A Consultation Paper*, December 1999, para 37

345 LEASE's response to *Residential Leasehold Reform in England and Wales.* March 1999, p 13

346 ARMA's observations on the Government's leasehold reform consultations, March 1999

347 HL Deb 13 November 2001 cc 554-6 & HL Deb 19 November 2001 cc 939-41

348 HL Deb 19 November 2001 c 942

requirement to insure with a company nominated by the landlord as they feel it interferes with their choice to obtain the best terms and conditions available.

In Grand Committee on the first Bill Baroness Hanham moved an amendment to insert a new clause that would have voided provisions in a lease requiring a tenant to insure with a company nominated by the landlord.[349] Lord Whitty expressed an understanding with the sentiment behind the amendment but also noted that landlords have a legitimate interest in ensuring that their properties are properly insured. He stated that the Government would look at this issue in the longer term outside the scope of the Bill.[350]

[349] HL Deb 22 March 2001 CWH 273-4
[350] HL Deb 22 March 2001 CWH 274-5