IN THE MATTER OF THE LAW COMMISSION

AND LEASEHOLD ENFRANCHISEMENT REFORM

AND THE COMPATIBILITY OF THE VARIOUS OPTIONS FOR REFORM

WITH ARTICLE 1 OF THE FIRST PROTOCOL

OF THE EUROPEAN CONVENTION ON HUMAN RIGHTS

OPINION

INTRODUCTION

1. The Law Commission for England and Wales is undertaking a project on reform of leasehold enfranchisement, which concerns the right of leaseholders under the Leasehold Reform Act 1967 ("1967 Act") and the Leasehold Reform, Housing and Urban Development 1993 ("1993 Act") to purchase the freehold of their house, participate with other leaseholders in the collective purchase of the freehold of a group of flats ("collective enfranchisement"), and to extend the lease of their house or flat.

2. In order to exercise the statutory right to enfranchisement, a leaseholder must pay a premium to a landlord in respect of the property interest that the leaseholder acquires. The Law Commission's Terms of Reference, agreed with the Government, require it "to examine the options to reduce the premium (price) payable by existing and future leaseholders to enfranchise, whilst ensuring sufficient compensation is paid to landlords to reflect their legitimate property interests".[1] A central issue in determining whether compensation is "sufficient" is whether it is compatible with landlords' right to enjoyment of their property under Article 1 of the First Protocol ("A1P1") to the European Convention on Human Rights ("ECHR").

[1] The Law Commission's Terms of Reference are set out in Appendix 3 to the Law Commission's Consultation Paper "*Leasehold home ownership: buying your freehold or extending your lease*" (September 2018).

3. I have been instructed by the Law Commission to provide an independent opinion on the compatibility with A1P1 of various options for reforming how the premium paid is determined, including options that would reduce the premium payable by leaseholders.

4. The structure of my advice is as follows:

   (1) First, my advice explains what A1P1 of the ECHR guarantees, why A1P1 is relevant in the context of leasehold enfranchisement, and the scope of those who are entitled to rely on it;

   (2) Second, my advice summarises the legal principles governing the application of A1P1 in both the case law of the European Court of Human Rights ("ECtHR") and in domestic law, in so far as it is relevant to leasehold enfranchisement;

   (3) Third, my advice addresses each of the options for reform and explains whether and why the options for reform are compatible with A1P1, and the level of risk of a finding, by either domestic courts or the ECtHR, of incompatibility of any of those options. In this section, my advice addresses the various considerations which are likely to have a bearing on the legality of the Law Commission's options for reform. When assessing the risk of incompatibility with A1P1, I have, as instructed, sought to follow the approach in the Government Legal Department's Guidance Note on Legal Risk. [2]

5. The views expressed in this advice on the compatibility of the various options for reform with A1P1 are necessarily provisional because it is not yet clear what final form the legislative scheme will take, and any definitive view will only be possible once all elements of the scheme can be considered as a whole.

[2] See: https://www.gov.uk/government/publications/guidance-note-on-legal-risk. The GLD risk framework uses four risk categories to indicate the likelihood of a legal challenge being successful: High (70%+); Medium High (50-70%); Medium Low (30-50%); and Low (less than 30%). Where I consider that the risk is more finely balanced (i.e. around 50/50), I have indicated that in the text below and stated on which side of the line I consider the risk lies.

A1P1

6. A1P1 provides:

> "Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.
>
> The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties."

7. A1P1 has been incorporated into English law by the Human Rights Act 1998. A1P1 protects the right to the peaceful enjoyment of possessions, and in substance guarantees the right of property.[3] "Possessions" include real and immovable property, and therefore A1P1 protects any proprietary interest in land.

8. A1P1 can be invoked by any "natural or legal person" who has suffered an interference with their possessions for which the state is responsible, and can therefore be invoked not only by an individual but also by a company or other legal entity (whether based in the UK or elsewhere).

9. A1P1 is a qualified right. An interference with a person's property rights can be justified where a legitimate aim is pursued by reasonably proportionate means. This involves an assessment of whether a fair balance has been struck between the demands of the general interest of the community and the requirements of the protection of the individual's rights. The payment of compensation is relevant to the fairness of the balance struck.

10. Legislation which permits a leaseholder to compulsorily acquire the freehold or extend the lease of a house or flat interferes with a landlord's property rights under A1P1 and will only be lawful if the level of compensation payable to the landlord is sufficient to justify the interference with those property rights.

[3] Marckx v Belgium (1979) 2 EHRR 350 at [63]; Sporrong and Lönnroth v Sweden (1982) 5 EHRR 35 at [57].

11. Given that the Human Rights Act 1998 requires the Government to confirm that, in its view, proposed legislation is compatible with the Convention rights, and that a court has the power to declare that any provision of primary legislation is incompatible with a Convention right, the Law Commission and the Government will be concerned to ensure that the chosen option for reform is compatible with landlords' A1P1 rights.

12. It is important to bear in mind that leaseholders also enjoy rights that are protected under the ECHR. Leaseholders enjoy the right to the peaceful enjoyment of their possessions under A1P1. Residential leaseholders who are owner-occupiers also benefit from the right to respect for their home under Article 8. However, leasehold enfranchisement legislation does not interfere with leaseholders' property rights under A1P1. Leaseholders' interests are taken into account when determining the amount of compensation payable to landlords, as the exercise of assessing whether a fair balance has been struck necessarily entails balancing the interests of landlords against the interests of leaseholders, both in their own right and when considering the general interest of society.

13. Article 8 is not concerned with the right to own or occupy property as such.[4] Article 8 is not engaged or violated either by the ordinary operation of a lease (which limits a leaseholder's occupancy of the property to the term of the lease) or by requiring the leaseholder to pay for the extension of the lease or purchase the freehold to avoid that result.[5]

14. For these reasons, the focus of this advice must be on the compatibility of the various options for reform with landlords' A1P1 rights.

RELEVANT LEGAL PRINCIPLES

15. The general principles governing the interpretation and application of A1P1 are well established in Strasbourg case law.

Analytical structure

16. The ECtHR has analysed A1P1 as comprising three distinct rules or categories of interference with property rights. The first rule is a rule of a general nature, set out in the

[4] See Harrow London Borough Council v Qazi [2004] 1 AC 983 at [50]-[53] per Lord Hope.
[5] See Malekshad v Howard de Walden Estates Ltd [2002] QB 364 at [49]-[53] per Sedley LJ (overturned by the House of Lords on a different issue).

first sentence of the first paragraph, and enunciates the principle of the peaceful enjoyment of property ("Every natural or legal person is entitled to the peaceful enjoyment of his possessions"). The second rule, contained in the second sentence of the first paragraph, covers deprivation of possessions and subjects it to certain conditions ("No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law"). The third rule, stated in the second paragraph, recognises that states are entitled to control the use of property in accordance with the general interest.[6]

17. The Strasbourg Court in James v UK (1986) 8 EHRR 123 added at [37] that the three rules are not, however, distinct in the sense of being unconnected: the second and third rules are concerned with particular instances of interference with the right to peaceful enjoyment of property and should therefore be construed in the light of the general principle enunciated in the first rule. The Court will generally consider whether an interference with a possession amounts to a deprivation of property falling within the second rule, or if not, a control of use falling within the third rule, and if neither, whether it falls within the more general principle enunciated in the first rule.

18. If there has been an interference falling within any of these rules, the test for whether there has been a violation of A1P1 is in substance the same, no matter how the interference has been classified. First, it must be shown that the interference is lawful. Second, it must be shown that the interference pursues a legitimate aim in the public (or general) interest. Third, it must be shown that the interference is proportionate.

19. However, the classification of the interference remains relevant because it affects the strictness of the operation of the proportionality principle and the duty to compensate. The Court will generally apply closer scrutiny to interferences involving deprivation or expropriation of property than to those involving a control of use. A deprivation of property will give rise to a duty to compensate the victim in all but the most exceptional circumstances, whereas there is generally no requirement for compensation in a case of

[6] See Sporrong and Lönnroth v Sweden (1982) 5 EHRR 35 at [61] and repeated in many subsequent cases. See also AXA General Insurance Ltd v HM Advocate [2012] 1 AC 868 at [107] per Lord Reed, where this analysis was adopted.

control of use. Rather, the availability of compensation will be relevant to whether a fair balance has been struck.

Deprivation

20. A 'deprivation' of property will have occurred where the rights of the owner have been extinguished by operation of law and ownership has been transferred. Examples include the expropriation of land for planning purposes[7] and the nationalisation of industries.[8] In James v UK (1986) 8 EHRR 123, the ECtHR held that the compulsory purchase by a leaseholder of the landlord's freehold interest in a house under the 1967 Act constitutes a 'deprivation' of possessions for the purpose of A1P1.

21. In addition to a *de jure* deprivation, the ECtHR will also look to the realities of the situation to determine whether there has been a *de facto* expropriation. A *de facto* deprivation will arise where, although there is no formal transfer of ownership of the property, the impact of a measure or action by the state is so profound that the owner's rights are rendered useless in practice. In a rare example of such a *de facto* deprivation, the Strasbourg Court in Papamichalopoulos v Greece (1993) 16 EHRR 440 held that there was a *de facto* deprivation of the applicant's property in circumstances where the Greek Navy Fund took possession of the applicant's land and established a naval base and holiday resort there, and deprived the applicant of the ability to use, mortgage, sell or otherwise dispose of the land.

Control of use

22. Where a property owner retains at least some property rights, then the loss or restriction of a property right is likely to be regarded as a control of use, rather than a deprivation.[9] Examples of control of use include planning controls[10] and other measures restricting the

[7] See Papachelas v Greece (1999) 30 EHRR 923; Jokela v Finland (2003) 37 EHRR 26; Efstathiou v Greece (2006) 43 EHRR 24; Vistinš v Latvia (2014) 58 EHRR 4.
[8] See Lithgow v UK (1986) 8 EHRR 329 (nationalisation of the aircraft and shipbuilding industries); Grainger v UK (App. No. 34940/10) (nationalisation of Northern Rock bank).
[9] See Banér v Sweden (App No 11763/85); Rook *Property Law and Human Rights* (2001), para 4.6.3.
[10] See Pine Valley Development Limited v Ireland (1991) 14 EHRR 319.

uses to which land can be put,[11] the imposition of positive obligations on the land owner,[12] and the loss of exclusive rights over property.[13]

23. Of more relevance in the current context, rent control legislation imposing limits on the amount of rent that property owners can demand from tenants, thus depriving the property owner of rental income, have been held to amount to a control of use of property.[14] Measures that suspend the enforcement of eviction orders, thus delaying landlords from recovering possession of their property, have been held to be a control of use of property.[15] Likewise, measures granting tenants the right to retain possession of premises indefinitely, thus depriving a landlord of the ability to terminate a lease, have been held to be a control of use of property.[16] In Lindheim v Norway (2015) 61 EHRR 29, compulsory extension of ground leases, on the same terms as previously negotiated and for an indefinite duration, was held to amount to a control of use of property.

Lawfulness of the interference

24. Interference with possessions is required to be lawful ("subject to the conditions provided for by law") to be compatible with A1P1. The principle of lawfulness entails not only the existence of a legal basis for the interference in domestic law, but also that the measure is compatible with the rule of law, such that it is sufficiently accessible, precise and foreseeable in its application, and does not operate arbitrarily.[17] It is extremely rare for the ECtHR to find that a measure interfering with property rights is not lawful.[18]

Legitimate aim in the public interest

25. In order to be compatible with A1P1, it must be shown that the interference pursues a legitimate aim in the public or general interest. The ECtHR has made clear, in a long line

[11] See Sporrong and Lönnroth v Sweden (1982) 5 EHRR 35 (where a prohibition on construction was held to be a control of use).
[12] See Denev v Sweden (1989) 59 DR 127 (imposition of a requirement to plant trees on land).
[13] See Banér v Sweden (App No 11763/85) (loss of exclusive fishing rights); Chassagnou v France (1999) 29 EHRR 615 (compulsory transfer of exclusive hunting rights over land).
[14] See Mellacher v Austria (1989) 12 EHRR 391; Hutten-Czapska v Poland (2007) 45 EHRR 4; Zammit v Malta (2017) 65 EHRR 17.
[15] See Spadea and Scalabrino v Italy (1995) 21 EHRR 482; Scollo v Italy (1996) 22 EHRR 514; Immobiliare Saffi v Italy (1999) 30 EHRR 756
[16] See Amato Gauci v Malta (2011) 52 EHRR 25.
[17] See Hentrich v France (1994) 18 EHRR 440 at [40]-[42]; The Former King of Greece v Greece (2001) 33 EHRR 21 at [79]-[82]; Vistinš v Latvia (2014) 58 EHRR 4 at [96]-[97].
[18] In Hentrich v France, the ECtHR held that a French law of pre-emption was unlawful because it operated arbitrarily, selectively and lacked basic procedural safeguards.

of cases, that the national authorities enjoy a wide margin of appreciation in determining what is in the public interest, both with regard to determining the existence of a problem of public concern and in identifying the remedial action to be taken. The ECtHR has noted that housing is a central concern of social and economic policies, and has held that in this area, it will respect the state's judgment as to what is in the public interest unless it is "manifestly without reasonable foundation".[19]

26. In particular, the ECtHR has held, in James v UK, that addressing perceived social injustice in the housing sector is a legitimate aim in the public interest, and therefore that the aim pursued by the 1967 Act was legitimate, even where such legislation interfered with existing contractual relations between private parties and conferred no direct benefit on the community at large. In Lindheim v Norway, the ECtHR held that laws controlling the use of property for broad social policy reasons will satisfy the public interest test, even where they are not aimed at addressing situations of potential financial hardship or social injustice.[20]

27. More generally, the UK Courts have agreed that the fairness of a system of law governing the contractual or property rights of private persons is a matter of public concern, and that legislative provisions intended to bring about such fairness are capable of being in the public interest, even if they involve the compulsory transfer of property from one person to another.[21]

28. The ECtHR has also held that laws effecting the compulsory transfer of property will satisfy the public interest test where they are aimed at economic reform of a sector or general measures of economic strategy.[22]

29. Laws which aim to provide clear and foreseeable solutions in a complex field and which seek to avoid costly and time-consuming litigation have been held to pursue a legitimate

[19] See James v UK (1986) 8 EHRR 123 at [46]-[47]; Mellacher v Austria (1989) 12 EHRR 391 at [45]; Spadea and Scalabrino v Italy (1995) 21 EHRR 482 at [29]; Scollo v Italy (1996) 22 EHRR 514 at [28]; Hutten-Czapska v Poland (2007) 45 EHRR 4 at [165]-[166]; Amato Gauci v Malta (2011) 52 EHRR 25 at [54]; Lindheim v Norway (2015) 61 EHRR 29 at [96]-[100].
[20] See [96]-[100].
[21] See Wilson v First County Trust Ltd (No.2) [2004] 1 AC 816 at [68] per Lord Nicholls.
[22] See, for example, Lithgow v UK (1986) 8 EHRR 329; Grainger v UK (App. No. 34940/10) at [36] & [39].

aim in the public interest.[23] The Court of Appeal in R (Newhaven Port & Properties Ltd) v East Sussex CC (No.2) [2014] QB 282 held at [64] that an attempt to clarify the law is itself a legitimate aim.

30. It is therefore evident that the notion of "public interest" is extensive, and that the ECtHR's intensity of review in this area is low. Consequently, it is rare for the Court to find that the public interest test is not satisfied.

Proportionality

31. The ECtHR has held that in relation to any type of interference falling within the scope of A1P1, there must be a reasonable relationship of proportionality between the means employed and the aim sought to be realised. In Strasbourg jurisprudence, this involves an assessment of whether a 'fair balance' has been struck between the demands of the general interests of the community and the requirements of the protection of the individual's fundamental rights. The requisite balance will not be found if the person concerned has had to bear an 'individual and excessive burden'.[24]

32. In determining whether a fair balance has been struck, the ECtHR has accorded national authorities a reasonably wide margin of appreciation, with regard both to choosing the means of enforcement and to ascertaining whether the consequences of enforcement are justified in the general interest for the purpose of achieving the object of the law in question.[25] The Strasbourg Court has previously suggested that in the housing sphere, it would respect the national authority's judgment unless it was 'manifestly without reasonable foundation'.[26] However, more recent cases indicate a preference to apply a greater intensity of review in the context of landlord/tenant relationships.[27] Regardless, it is at least clear that the more significant and important the public interest at stake, the

[23] See Lindheim v Norway (2015) 61 EHRR 29, at [94], [96]-[100], [125].
[24] See, for example, James v UK at [50]; Mellacher v Austria at [48]; Spadea v Italy at [33], Former King of Greece v Greece at [89]; Jahn v Germany (2006) 42 EHRR 49 at [93]-[95]; Hutten-Czapska v Poland at [167]; Amato Gauci v Malta at [56]-[57].
[25] See Chassagnou v France (2000) 29 EHRR 615 at [75]; Jahn v Germany (2006) 42 EHRR 49 at [93]; Scordino v Italy (2007) 45 EHRR 7 at [94]; JA Pye (Oxford) Ltd v UK (2008) 46 EHRR 45 at [75]; Vistiņš v Latvia (2014) 58 EHRR 4 at [109].
[26] See Immobiliare Saffi v Italy (1999) 30 EHRR 756 at [49]; JA Pye (Oxford) Ltd v UK (2008) 46 EHRR 45 at [75].
[27] See Lindheim v Norway (2015) 61 EHRR 29; Zammit v Malta (2017) 65 EHRR 17.

greater will be the margin of appreciation accorded to national authorities, and the lower the intensity of review by the Strasbourg Court.[28]

33. The assessment of proportionality requires careful consideration of the particular facts. In particular, the striking of a fair balance will depend on a number of different factors. For example, it may depend on whether there are procedural safeguards in place to give the person affected a reasonable opportunity to put their case to the responsible authorities for the purpose of effectively challenging a measure interfering with their property rights.[29] It may depend on the extent to which the contested legislation was the subject of extensive public debate or extensive consideration in Parliament, and the extent to which the national authorities and courts considered the balance between the private interests involved and the public interest.[30]

34. The Strasbourg Court may also consider whether there were less intrusive measures that could reasonably have been resorted to, and whether the national authorities examined the possibility of applying these less intrusive solutions.[31] However, the ECtHR has held that there is no test of strict necessity under A1P1. In James v UK, in the context of leasehold reform legislation, the Court held at [51]:

> "This amounts to reading a test of strict necessity into the Article, an interpretation which the Court does not find warranted. The availability of alternative solutions does not in itself render the leasehold reform legislation unjustified; it constitutes one factor, along with others, relevant for determining whether the means chosen could be regarded as reasonable and suited to achieving the legitimate aim being pursued, having regard to the need to strike a 'fair balance'. Provided the legislature remained within these bounds, it is not for the Court to say whether the legislation represented the best solution for dealing with the problem or whether the legislative discretion should have been exercised in another way."

35. Applying this approach in the nationalisation context, in Lithgow v UK (1986) 8 EHRR 329, the ECtHR held at [125]-[135] that the UK Parliament's decision to adopt a particular

[28] See Broniowski v Poland (2005) 40 EHRR 21 at [182]; Jahn v Germany (2006) 42 EHRR 49 at [113]-[117]; Grainger v UK (App No 34940/10), at [38]-[43].
[29] See Air Canada v United Kingdom (1995) 20 EHRR 150 at [44]-[46]; Jokela v Finland (2003) 37 EHRR 26 at [45]; Paulet v United Kingdom (App No 6219/08) 13 May 2014 at [65].
[30] See James v UK; Lithgow v UK; Friend v United Kingdom (2010) 50 EHRR SE6 at [56]-[58]; Lindheim v Norway (2015) 61 EHRR 29 at [126]-[128]; Paulet v United Kingdom (App No 6219/08) 13 May 2014 at [67]-[68]; R (Mott) v Environment Agency [2018] 1 WLR 1022 at [24], [36]-[37].
[31] See Vistiņš v Latvia (2014) 58 EHRR 4 at [129].

valuation method and valuation reference period for calculating compensation payable to nationalised industries, when other methods or reference periods were available, was proportionate. Likewise, in Mellacher v Austria (1989) 12 EHRR 391, the ECtHR held at [53], in the context of rent control legislation, that the existence of alternative solutions did not by itself render the contested legislation unjustified.

36. The availability of compensation and the compensation terms under the relevant legislative measure are material to the assessment of whether the contested legislation strikes a fair balance and is proportionate. This topic, of central importance in the current context, is addressed in the next section.

Compensation

37. Deprivation cases: A1P1 makes no express reference to compensation. However, from an early stage in its jurisprudence, the ECtHR has interpreted A1P1 as impliedly requiring the payment of compensation as a necessary condition for the deprivation of property. The taking of property is generally required to be compensated in an amount 'reasonably related to its value' (usually treated as 'market value'). Generally, the taking of property without payment of an amount reasonably related to its value will constitute a disproportionate interference. The taking of property without payment of any compensation at all will generally be considered justifiable only in exceptional circumstances.[32]

38. However, the Strasbourg Court has held that A1P1 does not guarantee a right to full compensation in all circumstances involving deprivation of property. Legitimate objectives of public interest such as pursued in measures of social, economic or political reform or measures designed to achieve greater social justice, may call for less than reimbursement of the full market value. In the context of wide-reaching economic or social reforms, which have a significant economic impact for the country as a whole, the Court

[32] See James v UK at [54]; Lithgow v UK at [120]-[121]; Papamichalopoulos v Greece (1993) 16 EHRR 440 at [41]-[46]; Holy Monasteries v Greece (1994) 20 EHRR 1 at [71]-[75]; Former King of Greece v Greece (2001) 33 EHRR 21 at [89]-[99]; Scordino v Italy (2007) 45 EHRR 7 at [95]; Vistinš v Latvia (2014) 58 EHRR 4 at [110]-[111].

gives national authorities a wide margin of appreciation in relation to the determination of the amount of compensation to be awarded to affected persons.[33]

39. The Strasbourg Court has held that the state may justify a substantial reduction in the level of compensation payable in the following circumstances:

    (1) National reform of property laws to correct a perceived injustice, such as leasehold enfranchisement legislation (James v UK);

    (2) Nationalisation of an entire industry or a bank (Lithgow v UK; Grainger v UK);

    (3) Radical reform of a state's political and economic system, such as occurred during the process of German reunification or in the transition from a communist to a democratic state (Jahn v Germany; Broniowski v Poland; Vistinš v Latvia).[34]

40. In contrast, where a discrete property is expropriated for planning purposes or public use, and not as part of a process of economic, social or political reform, it will be difficult to justify less than compensation of the market value of the property. Hence, in Scordino v Italy (2007) 45 EHRR 7, where the applicant's land was expropriated for construction of local housing, payment of less than half the market value was held to violate A1P1.[35]

41. The principle to be derived from these cases is that there is a direct relationship between the importance of the public interest pursued and the compensation which should be provided under A1P1. The Court has held that a 'sliding scale' should be applied, balancing the importance of the public interest against the amount of compensation provided to the affected persons.[36] The greater the public interest objective of the measure, the easier it is to justify stringent limitations on compensation. Conversely, where the public interest being pursued by the measure is not so significant, the closer the compensation payable should be to the market value. Thus, in Biskupice v Slovakia, where the main aim of the expropriatory legislation was to reinforce legal certainty, and the persons benefitting from transfer of ownership did not belong to a socially weak or

[33] See James v UK at [54]-[56]; Lithgow v UK at [121]; Broniowski v Poland (2005) 40 EHRR 21 at [182]; Scordino v Italy at [97]-[102]; Biskupice v Slovakia (2009) 48 EHRR 49 at [115].
[34] For a useful summary of the principles and the cases, see Scordino v Italy at [97]-[98].
[35] (2007) 45 EHRR 7 at [102]-[103];
[36] Biskupice v Slovakia at [126].

vulnerable part of the population, the ECtHR held that the compensation payable should have reflected the market value of the land.[37]

42. In SRM Global Master Fund LP v Commissioners of Her Majesty's Treasury [2009] EWCA Civ 788 (the Northern Rock case) at [56], Lord Justice Laws expressed the principle in this way:

> "The paradigm case of a reasonable relationship between compensation and the property's value arises, no doubt, where full market value is paid. In that case the relationship between the two is one of identity. That or something not far off is likely to apply in what may be called a 'micro-economic' setting, where for example a single property is taken to achieve a specific and limited local objective. In such a case proportionality is likely to require market value or something close to it, and the margin of appreciation may offer little or no scope to justify the deprivation of property for less. But there will be other cases in which the objective of the deprivation is much broader: perhaps a matter of high politics. In such instances the policy aim of the measure in question may be diminished or undermined or even contradicted by a requirement of full market value. The measure's intention may be to re-distribute wealth, or to achieve a necessary social reform, goals which are or may be perceived to be inconsistent with full compensation payable to the previous owner. In these cases, the margin of appreciation allows a flexible approach to the right protected by A1P1 which may give place to those aspects of the policy which override the case for payment of full value."

43. The value of expropriated property should normally be determined at the time of the deprivation to avoid uncertainty and arbitrariness.[38] On the other hand, there may be circumstances which justify assessment of value by reference to a different period of time. In Lithgow v UK, the ECtHR held that the UK was justified in selecting a valuation reference period which pre-dated the formal transfer of property by three years, because any later period, post-dating the announcement of the nationalisation of the relevant industries, would have distorted the value of the relevant shares.[39]

44. There is also somewhat of a tension in the case law as to the extent to which the provisions for compensation are required to take account of differing situations. In a number of linked decisions, where the Greek state expropriated approximately 150 properties to build a major new road, the ECtHR held that the application of an irrebuttable legislative

[37] Ibid at [131].
[38] See Vistinš v Latvia at [111].
[39] (1986) 8 EHRR 329 at [131]-[135].

presumption that owners had derived an economic benefit from the building of the road which limited their recovery of compensation, violated A1P1.[40] The Court found that the system's inflexibility, its failure to take account of the nature of the works or the layout of the site, and its failure to enable the owners to argue that the works had been of less or no benefit to them, imposed an individual and excessive burden on the owners.[41]

45. Similarly, in R (Kelsall) v Secretary of State for Environment, Food and Rural Affairs [2003] EWHC 459 (Admin), the High Court held that a scheme for compensating mink fur farmers for the loss of their fur farming businesses resulting from the Fur Farming Prohibition Act 2000 was unfair, irrational and violated A1P1 in circumstances where the scheme provided compensation for the residual breeding value of female mink only (despite the significant value of male breeding mink), and failed to distinguish between different breeds of mink, thereby discriminating against farmers who reared premium breeds.[42]

46. However, in cases involving expropriation legislation of wide sweep, the Strasbourg Court has been more accepting of compensation schemes which adopt a common valuation formula that applies across the board, and which result in some anomalies. In James v UK, the affected landlords argued that the 1967 Act granting leasehold enfranchisement rights was indiscriminate since it did not provide any machinery whereby the landlords could seek an independent consideration of either the justification for enfranchisement or the principles on which compensation was to be calculated. The landlords also pointed out that the legislation benefitted not only tenants who were needy or deserving of protection but better-off middle-class tenants, many of whom were making undeserved windfall profits on re-selling their property after enfranchising. The Strasbourg Court rejected these arguments, stating that:

> "Parliament chose instead to lay down broad and general categories within which the right of enfranchisement was to arise. The reason for this choice, according to the Government, was to avoid the uncertainty, litigation, expense and delay that would inevitably be caused for both tenants and landlords under a scheme of individual examination of each of many thousands of cases. Expropriation legislation of wide

[40] See Katikaridis v Greece, Tsomtsos v Greece (2001) 32 EHRR 6; Papachelas v Greece (1999) 30 EHRR 923 at [51]-[55].
[41] Papachelas v Greece at [53]-[54].
[42] See [45]-[56] & [62]-[64].

sweep, in particular if it implements a programme of social and economic reform, is hardly capable of doing entire justice in the diverse circumstances of the very large number of different individuals concerned."[43]

"An inevitable consequence of the legislation giving effect to [the view that the tenant had a 'moral entitlement' to ownership of the house] is that any tenant who sells the unencumbered freehold of the property (comprising house and land) after enfranchising is bound to make an apparent gain, since the price of enfranchisement, at least on the 1967 basis of valuation, did not include the house and the tenant has benefitted from the so-called merger value. In addition, the broad sweep and scale of the redistribution of interests achieved by the reform mean that some anomalies, such as the making of 'windfall profits' by tenants who purchased end-of-term leases at the right time, are unavoidable. Parliament decided that landlords affected by the legislation should be deprived of the enrichment, considered unjust, that would otherwise come to them on reversion of the property, at the risk of a number of 'undeserving' tenants being able to make 'windfall profits'. That was a policy decision by Parliament, which the Court cannot find to be so unreasonable as to be outside the State's margin of appreciation."[44]

47. In Lithgow v UK, in which nationalised aircraft and shipbuilding industries challenged the compensation paid to them as grossly inadequate and discriminatory, the Strasbourg Court held that the valuation of major industrial enterprises for the purpose of nationalising a whole industry was in itself a far more complex operation than, for instance, the valuation of land compulsorily acquired, and normally called for legislation which could be applied "across the board to all the undertakings involved".[45] In response to the argument that the compensation provisions failed to take account of subsequent developments in the affected companies' fortunes up to the date of vesting of the shares, the Court held:

"When a nationalisation measure is adopted, it is essential – and this the applicants accepted – that the compensation terms be fixed in advance. This is not only in the interests of legal certainty but also because it would clearly be impractical, especially where a large number of undertakings is involved, to leave compensation to be assessed and fixed subsequently on an *ad hoc* basis or on whatever basis the

[43] James v UK at [68].
[44] Ibid, at [69]. Likewise, in JA Pye (Oxford) Ltd v UK (2008) 46 EHRR 45, in the context of the law on adverse possession, the Strasbourg Court held at [83] that the acquisition of unassailable rights by the adverse possessor must go hand in hand with a corresponding loss of property rights for the former owner, and that the possibility of an 'undeserving' person being able to gain a 'windfall' did not affect the overall assessment of the proportionality of the legislation on limitation periods.
[45] Lithgow v UK at [121].

Government might at their discretion select in each individual case. The Court recognises the need to establish at the outset a common formula which, even if tempered with a degree of inbuilt flexibility, is applicable across the board to all the companies concerned."[46]

48. Notably, the Court also found that A1P1 did not oblige the UK to treat the owners of the nationalised industries differently according to the class or size of their shareholdings in the nationalised undertakings, and that the UK did not act unreasonably in taking the view that compensation would be more fairly allocated if all the owners were treated alike.[47]

49. A further principle that arises from the Strasbourg jurisprudence is that the assessment of market value of land under an expropriation regime should be reasonably consistent with the assessed market value of the same land under another regime (for example, taxation); and in absence of consistency, the onus is on the state to provide a sufficient explanation for the differing valuations of the property.[48] The Court has held that property owners have a legitimate expectation of a reasonable consistency between decisions concerning the same property.[49]

50. Control of use cases: Generally, in a case involving control of use of property rather than deprivation of property, there is no entitlement to, or presumption in favour of, compensation.[50] Rather, the availability of compensation is one of the factors relevant to whether a fair balance has been struck; in each case, the question is whether compensation is required to achieve a fair balance between the public interest pursued and the private property interests affected.[51]

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[46] Ibid at [139(a)].
[47] Ibid at [149].
[48] See Jokela v Finland (2003) 37 EHRR 26 at [61]-[65]. See also Biskupice v Slovakia at [142]-[146] in which the fact that rent payable by tenant gardeners to the owners of the land was less than the property tax payable in respect of the land was one of the relevant factors in finding that a fair balance had not been struck.
[49] See Jokela v Finland at [61] & [65].
[50] See Baner v Sweden (1989) 60 DR 125 at [6]; Fredin v Sweden (1991) 13 EHRR 784; Tre Traktorer Aktiebolag v Sweden (1989) 13 EHRR 309; R (Trailer & Marina (Leven) Ltd) v Secretary of State for the Environment, Food and Rural Affairs [2004] EWHC 153 (Admin) at [80]; affirmed in [2005] 1 WLR 1267 (CA) at [45]-[46] per Neuberger LJ (as he then was).
[51] Draon v France (2005) 42 EHRR 807 at [79]; Trailer & Marina (Leven) Ltd (HC) at [80]; CA at [56]-[58]; R (Newhaven Port & Properties Ltd) v East Sussex CC [2014] QB 282 at [54]; Thomas v Bridgend CBC [2012] QB 512 at [53]-[59]; Cusack v Harrow LBC [2013] 1 WLR 2022 at [42] per Lord Carnwath and

51. In cases that are closer to a deprivation than a control of use, or where the control of use has severe economic consequences to the detriment of the affected property owner, it may be necessary to pay compensation to avoid a breach of A1P1.[52] Hence, in R (Mott) v Environment Agency [2018] 1 WLR 1022, an executive decision to drastically limit the number of salmon permitted to be caught in the Severn estuary, which eliminated 95% of the claimant's commercial fishing right and therefore had a particularly damaging impact on the claimant's livelihood, was held to violate A1P1 in part because of the lack of compensation. In Biskupice v Slovakia, Amato Gauci v Malta and Lindheim v Norway, the very low levels of rent received by land owners pursuant to the compulsory letting of their land, which bore no relation to the actual value of the land, were also held to strike an unfair balance in violation of A1P1.[53]

Relevant legal principles in domestic case law

52. In general, the UK courts adopt the same principles and approach to the application of A1P1 as the Strasbourg Court.[54]

53. However, the approach of the domestic courts differs in two material respects. First, the UK courts generally apply a more structured, four-limbed test of proportionality when considering alleged violations of qualified Convention rights (including A1P1) under the Human Rights Act.[55] The four component parts of the test are:

    (1) Whether the objective of the measure is sufficiently important to justify the limitation of a protected right;
    (2) Whether the measure is rationally connected to the objective;

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[66]-[67] per Lord Neuberger; R (British American Tobacco UK Ltd) v Secretary of State for Health [2018] QB 149 (CA) at [113].

[52] See Thomas v Bridgend at [56]; R (Mott) v Environment Agency [2018] 1 WLR 1022 at [32]-[37].

[53] Biskupice v Slovakia at [140]-[146]; Amato Gauci v Malta at [56]-[64]; Lindheim v Norway at [77], [129]-[136].

[54] See, for example, Trailer and Marina (Leven) Ltd [2005] 1 WLR 1267 (CA); R (Countryside Alliance) v Attorney General [2008] 1 AC 719; SRM Global Master Fund LP v Commissioners of Her Majesty's Treasury [2009] EWCA Civ 788; AXA General Insurance Ltd v HM Advocate [2012] 1 AC 868 per Lord Reed; Salvesen v Riddell [2013] UKSC 22; Cusack v Harrow LBC [2013] 1 WLR 2022.

[55] See R (Aguilar Quila) v Secretary of State for the Home Department [2012] 1 AC 621 at [45]; Bank Mellat v HM Treasury (No 2) [2014] AC 700 at [20] per Lord Sumption and [68]-[76] per Lord Reed; In re Recovery of Medical Costs for Asbestos Diseases (Wales) Bill [2015] AC 1016 at [45]; R (Steinfeld) v Secretary of State for International Development [2018] 3 WLR 415 at [41].

(3) Whether a less intrusive measure could have been used without unacceptably compromising the achievement of the objective; and

(4) Whether a fair balance has been struck between the rights of the individual and the interests of the community.

54. The third limb of the test ("less intrusive measure") may suggest that UK courts apply a test of strict necessity in the context of A1P1, but in my view, this would not be accurate. In R (Clays Lane Housing Co-operative Ltd) v Housing Corporation [2005] 1 WLR 2229, the Court of Appeal expressly rejected a test of strict necessity in the context of A1P1, finding at [18]-[25] that if "strict necessity" were to compel the "least intrusive" option, decisions which were distinctly second best or fraught with adverse consequences would become mandatory. Lord Brown in R (Countryside Alliance) v Attorney General [2008] 1 AC 719 held at [155] that there is no test of strict necessity in A1P1. Lord Reed rejected such a test in AXA General Insurance Ltd v HM Advocate [2012] 1 AC 868 at [130], as did Lewison LJ in R (Newhaven Port & Properties Ltd) v East Sussex CC [2014] QB 282 at [75]. In Bank Mellat v HM Treasury (No 2) [2014] AC 700 at [75], Lord Reed expanded on his views, making it clear that, in respect of the third limb of the proportionality test, the courts were not called on to substitute their opinions for the legislative decision as to where to draw a precise line, and that it was essential to allow the legislature a margin of discretion as to its legislative choice, since a strict application of a "least restrictive means" test would allow only one legislative response to an objective that involved limiting a protected right.

55. Second, the concept of the 'margin of appreciation' does not apply in domestic law.[56] The margin of appreciation is a doctrine of an international court which has two elements: first, it recognises the relative disadvantage suffered by an international court in evaluating the needs and conditions of a Member State, and recognises that national authorities are in principle better placed to evaluate those local needs and conditions; second, it refers to the area of judgment within which the judiciary will defer, on democratic grounds, to the considered opinion of the elected body whose act is said to be incompatible with the

[56] See, for example, In re G (Adoption: Unmarried Couple) [2009] AC 173 at [118] per Baroness Hale; In re Recovery of Medical Costs for Asbestos Diseases (Wales) Bill at [44] per Lord Mance; R (Steinfeld) v Secretary of State for International Development at [28] per Lord Kerr.

Convention.[57] The application of the doctrine of 'margin of appreciation' in the context of A1P1 has often resulted in the Strasbourg Court being willing to defer to the choices made by national authorities.

56. The first element of the doctrine has no relevance in domestic law because the domestic court is not under the same disadvantages of physical and cultural distance as the international court.[58] In its second element, the margin of appreciation has a close affinity with the domestic doctrine of 'margin of discretion' or 'margin of judgment'.[59] The UK courts equally recognise that domestic courts cannot act as primary decision makers, that social and economic policies are the responsibility of the legislature, and that due weight must be given to the informed choices of a democratic legislature. The intensity of review by the domestic courts, or conversely, the degree of restraint practised by the courts in applying the principle of proportionality, and the extent to which they will respect or defer to the judgment of the primary decision-maker will depend in each case on the particular context, and will in part reflect national traditions and institutional culture.[60] In practice, the UK courts will accord weight to the decisions of the legislature in the field of social and economic policy, but will also carefully scrutinise whether a contested measure achieves a fair or proportionate balance between the public interest being promoted and all of the other relevant private interests involved.

57. The differences between the approach of the UK domestic courts and that of the Strasbourg Court will not necessarily lead to different results, but they are, in my view, likely to mean that the domestic courts will be more willing to apply greater scrutiny to a legislative measure that interferes with A1P1 rights than the Strasbourg Court.

[57] See SRM Global at [57]-[59].
[58] See In re Recovery of Medical Costs for Asbestos Diseases (Wales) Bill at [54].
[59] See SRM Global at [59].
[60] See, for example, AXA General Insurance Ltd v HM Advocate at [124] and [131] per Lord Reed; Bank Mellat at [71] per Lord Reed; In re Recovery of Medical Costs for Asbestos Diseases (Wales) Bill at [54] per Lord Mance.

CONSIDERATION OF OPTIONS FOR REFORM

General observations

58. Before turning to consider the various options for reform, it is necessary to make a number of general observations.

59. First, it is not possible to provide definitive advice on the compatibility with A1P1 of the various options for reform without knowing what form the final legislative scheme will take. In order to give such advice, consideration would need to be given, once the scheme is finalised, to a number of different factors, including: the aims and objectives of the scheme; the procedural safeguards available to enable affected landlords to challenge either the scheme itself or various elements within it; and the extent to which Parliament has considered the impact of the scheme on landlords as a group, as well as leaseholders.

60. In particular, a key factor affecting the compatibility of the scheme with A1P1 will be the aims and objectives of the eventual scheme. For example, if the primary aim of the scheme is to remedy perceived injustice faced by leaseholders, that will have a bearing on the scope of the reforms (including the identity of those who are to benefit from the reforms) and will feed into the assessment of proportionality, including the degree of scrutiny (or conversely, deference) the courts will apply to the scheme. If the Government's aim is to reform the leasehold enfranchisement system in order to make enfranchisement more simple, quick and cost-effective, that will change the scope of the scheme and the proportionality assessment accordingly. If the Government's aims are more ambitious – for example, deliberate redistribution of wealth from one group (landlords) to another (leaseholders) or even ending the system of leasehold altogether – that will also feed into the nature and scope of the scheme and the assessment of where the fair balance is to be struck in terms of compensation.

61. Therefore, this advice must necessarily be tentative in its conclusions, as I am advising without full knowledge of the shape of the eventual reforms.

62. Second, before considering the compatibility with A1P1 of the various options for reform, it is necessary to address the relevance and effect of the ECtHR decision in James v UK. In James v UK, the Strasbourg Court considered an A1P1 challenge to the UK's leasehold enfranchisement legislation, and specifically the right conferred on leaseholders by the

1967 Act to compulsorily acquire the freehold of their property. The valuation basis set out in section 9(1) of the 1967 Act, which was the subject of challenge in James v UK, is the least favourable to landlords because it compensates the landlord only for the loss of his or her land rather than the building upon it, and excludes marriage value from the premium payable. Nevertheless, the ECtHR held that the 1967 Act was compatible with A1P1. In particular, the ECtHR held that:

(1) The compulsory transfer of property from one private individual to another pursuant to the leasehold enfranchisement legislation was a deprivation of property within the meaning of the second sentence of A1P1;[61]

(2) Such compulsory transfer may constitute a legitimate means for promoting the public interest, and a taking of property effected in pursuance of legislation intended to enhance social justice within the community may be in the public interest even if the community at large has no direct use or enjoyment of the property taken. The aim of the 1967 Act was to right the injustice felt to be caused to occupying tenants by the operation of the leasehold system, and to give effect to the tenant's 'moral entitlement' to ownership of the house. The legislation therefore pursued a legitimate aim in the public interest;[62]

(3) The legislation was proportionate and struck a fair balance between the interests of landlords and those of the wider community. In particular, given the public interest objectives at stake, the section 9(1) basis of valuation struck a fair balance between the landlord's property interests and the general interest of society, even though the compensation payable did not represent the full market value of the properties;[63]

(4) There were no grounds for finding that the enfranchisement of the landlords' properties was arbitrary because of the terms of compensation provided. In particular, the UK legislature was entitled to enact expropriation legislation of wide sweep, which did not provide machinery for challenging the calculation of compensation, and which did not differentiate between 'deserving' and 'undeserving' tenants.[64]

[61] James v UK (1986) 8 EHRR 123, at [38].
[62] Ibid, at [39]-[49].
[63] Ibid, at [50]-[57].
[64] Ibid, at [67]-[69].

63. It might be thought, in light of those findings, that any options for reform which are no more favourable to landlords than the section 9(1) basis of valuation would therefore be immune from challenge. I note, for example, that in the context of lease extensions of flats under the 1993 Act, Lord Neuberger commented in Howard de Walden Estates Ltd v Aggio [2009] 1 AC 39 at [69] that, given the decision of the ECtHR in James v UK, "there is no basis for complaining about the statutory measure of compensation". In response to the landlords' argument that section 9 of the 1967 Act and Schedule 13 to the 1993 Act were inconsistent with A1P1, Lord Wilson in Earl Cadogan v Pitts & Sportelli [2010] 1 AC 226 observed at [48] that: "The decision of the Strasbourg court in *James v United Kingdom* (1986) 8 EHRR 123 presents them with an insuperable obstacle".[65]

64. However, I consider that it would not be safe to assume that any option for reform would be likely to yield the same result as in James v UK, for (at least) three reasons. First, the legislation being considered by the ECtHR was based on the concept that, while the land belonged to the landlord, morally the house belonged to the leaseholder. That approach reflected the position at the grant of a 99-year building lease (where the leaseholder is responsible for building the house). That would not be the basis on which any future leasehold reform would be enacted (and indeed, that concept has not been reflected in various amendments to the 1967 Act), not least because most leases currently granted are in respect of houses that have already been built.

65. Second, the case of James v UK was decided at a time when the legislation imposed a two-year residence requirement, which meant that only a leaseholder who resided in his or her house could qualify for enfranchisement rights. The residence requirement was abolished by the Commonhold and Leasehold Reform Act 2002, and replaced with a requirement that the leaseholder must have owned the house for at least two years (so that enfranchisement rights were extended to leaseholders who do not satisfy the resident test (because they are not occupiers) and who could not satisfy a residence test (for example, because they are a corporate body)). The Law Commission has provisionally proposed removing the two-year ownership requirement (for the reasons set out at paragraphs

[65] I note that Lord Wilson took into account, in reaching that conclusion, the fact that the scope of leasehold enfranchisement rights had increased greatly since the 1967 Act, especially with the removal of the requirement for occupation by the tenant. But his Lordship also placed great weight on the fact that marriage value was payable to the landlord under section 9(1D) of the 1967 Act and Schedule 13 to the 1993 Act.

7.118-7.121 and 8.75-8.77 of the Consultation Paper), which will benefit all leaseholders, both owner-occupiers and investors. The result of these changes will be that the nature and scope of the leaseholders who may benefit from enfranchisement rights will have greatly expanded since James v UK was decided, which is likely to affect where the fair balance should be struck (as addressed in more detail below).

66. Third, and in any event, as evident in the Strasbourg case law since James v UK was decided, and as observed by the ECtHR itself in Lindheim v Norway at [135], there have been "jurisprudential developments in the direction of a stronger protection under art.1 of Protocol No.1".

67. Lindheim is a particularly important and apposite case because of the similarities between the facts of that case and the current context, particularly in relation to the right to extend the lease of a house or flat. The applicants in that case were landowners who had entered into ground lease agreements as lessors for permanent homes or holiday homes to be built upon them by lessees. Such leases were generally concluded for 99 years and gave the lessee a right to extend the agreement upon expiry. They bear a strong similarity to building leases in England and Wales. Such ground lease agreements are prevalent in Norway (approximately 350,000 ground lease contracts in a population of 5 million people). In 2004, Norway introduced legislation which imposed limits on the rent which lessors could demand from ground lease agreements, and granted lessees the right to extend their agreements, upon expiry, on the same terms as previously negotiated and for an indefinite duration. The landowners asserted that the measure violated their A1P1 rights.

68. The ECtHR held that the measure amounted to a control of use of property, which had a legitimate aim in the public interest, but that it failed to strike a fair balance and therefore violated A1P1 for five reasons, namely: (i) there were no demands of the public interest which could justify the particularly low level of rent payable (which amounted to less than 0.25% of the plots' market value and was either equal to or lower than the statutory level of property tax payable on the plots), (ii) the compulsory lease extension was for an indefinite duration without any possibility of upward adjustment beyond inflation-indexed levels; (iii) the measure applied irrespective of the financial means of the lessee concerned; (iv) the Norwegian state itself had not assessed whether the measure struck a

fair balance between the interests of lessors and lessees; and (v) any increase in the value of land would accrue only to the lessee. In these circumstances, the lessors were made to bear a disproportionate burden.[66]

69. For all of these reasons, I do not consider that the findings in James v UK would necessarily apply today.

70. Finally, in assessing the various options for reform, I consider that it is important to have in mind the appropriate classification of the various interferences with property rights. The Law Commission has assumed, in its Consultation Paper, that the exercise of leasehold enfranchisement rights constitutes a deprivation of property within the meaning of the second sentence of A1P1. This is clearly correct in relation to the acquisition of the freehold of a house or block of flats (see James v UK).

71. However, I do not consider that it is necessarily correct in relation to a lease extension of a house or flat. In a lease extension (for example, under the 1993 Act), the leaseholder gets a new lease in substitution for the existing lease for a term which exceeds the term of the existing lease by 90 years and at a peppercorn ground rent. Consequently, the landlord loses the income stream for the remainder of the original term and the right to vacant possession (the reversion) for a further 90 years. However, the landlord's legal rights are not wholly extinguished and he or she remains the freehold owner of the property and is able to sell or dispose of the property. In those circumstances, I consider that a court is likely to regard a lease extension as a control of use of the property, rather than a deprivation. I note, for example, that forced lease extensions have been held to be a control of use in cases such as Mellacher, Hutten-Czapska, Amato Gauci, and Lindheim. I also note that in James v UK, although the 1967 Act covered lease extensions as well as acquisitions of freehold, only the provisions involving the transfer of property from landlord to leaseholder had been at issue; the Court in that case did not make any findings in relation to lease extensions.

72. The classification of a lease extension as a control of use has at least the potential to affect the assessment of proportionality, and the degree of scrutiny given to that aspect of the reforms by the courts, in so far as they are separately challenged. However, in practice, it

[66] See Lindheim v Norway (2015) 61 EHRR 29 at [128]-[135].

is unlikely to have a significant impact because there is no question in the enfranchisement reform context that landlords facing forced leasehold extensions will be entitled to receive compensation (and that the valuation methods adopted will be the same for both freehold acquisitions and leasehold extensions).

The General Approach: Possible Elements of any New Scheme

Differential pricing for different types of leaseholder

73. An option for Government is to provide differential pricing for different types of leaseholder, depending on the overall scheme adopted. At paragraphs 15.30 to 15.38 of the Consultation Paper, the Law Commission considers whether the premium which commercial investors should pay to exercise enfranchisement rights should be set differently from that payable by owner-occupiers. As differential pricing will inevitably add complexity to the law and may distort the market, the Law Commission considers that it may be desirable only if the human rights arguments mean that a significantly lower price could be provided to owner-occupiers.

74. Ultimately, whether the Government should limit the class of leaseholder eligible to benefit from leasehold enfranchisement rights or should provide differential pricing for different types of leaseholder will depend on the social policy objective being pursued and the level of premiums payable under the new scheme. If the primary aim of the reforms is to benefit ordinary homeowners and to redress perceived injustice suffered by them, then it is likely to be disproportionate and not rationally connected to the objective to bring within the class of leaseholder benefitting from enfranchisement reforms those who are not owner-occupiers. If commercial investors could rationally be brought within the scope of the scheme, the Government is likely to be required to introduce differential pricing if it wishes to set the premiums payable at a very low level, because such a low level of compensation is unlikely to be justified for those who are not owner-occupiers.

75. However, a two-tier valuation scheme is likely to have all of the defects identified by the Law Commission in paragraph 15.35 of its Consultation Paper. In particular, it is foreseeable that landlords will argue that a scheme under which premiums differ depending purely on the identity of the leaseholder is unfair and discriminatory.

76. If the Government's primary aim is to streamline and simplify the leasehold enfranchisement system, then it is rational for the scheme to include all classes of leaseholder within its scope and to provide one method of calculating premiums. However, as this policy objective would not be as significant or important as eliminating injustice in the housing sector, the premiums should be set at a level that is closer to market value in order to strike a fair balance between the interests of landlords and those of leaseholders and general society.

Prescribing rates

77. Valuation often involves the use of rates to determine capitalised or deferred capital sums, and for relativity. Identifying the appropriate rates can be difficult and contentious. The rate used can make a significant difference to the premium that will be paid. One of the options for reform introduced by the Law Commission is the idea of prescribing rates.

78. As the Law Commission has noted in my instructions, it is difficult to assess the compatibility with A1P1 of any prescribed rate without knowing what that rate might be and how it relates to the rate which would otherwise be applied by a valuer considering the individual attributes of a particular property. However, it seeks my advice on (a) whether prescribing rates would be compatible with A1P1, when the rate was intended to be a market rate, but prescription would necessarily mean that in some cases less than or more than a market rate may be obtained; and (b) where the rate is intentionally prescribed to be less than a market rate in order to produce a lower premium.

79. In relation to scenario (a), I consider that, at least in principle, prescribing a rate that is intended to be a market rate is likely to be compatible with A1P1. The concept of prescribing a rate is not of itself incompatible with A1P1. As the Strasbourg Court observed in Lithgow v UK, in the context of legislation which is intended to have a wide-reaching social and economic impact, it is justifiable to adopt a common formula which applies across the board, even if it is tempered with a degree of inbuilt inflexibility.

80. However, it would be important to ensure that the prescribed rate is not so inflexible that it does not in fact reflect the market rate in relation to particular categories of property or particular areas or particular lengths of lease. For example, in the case of deferment rates, it may be necessary to prescribe different deferment rates according to the location of the property or the length of the lease. I consider that if rates are to be prescribed, there would

need to be a fair and transparent procedure for setting and adjusting the rates, to ensure the rates adequately reflect changing developments over time. It should also be possible for landlords or leaseholders to challenge the method by which the rates are prescribed.

81. I also note that 'market value' in the context of enfranchisement claims is an imprecise, flexible and in some cases artificial concept. Valuation is not an exact science, and in practice, professional valuers disagree about the appropriate rates for capitalisation, deferment and relativity. As there is no definitively 'correct' capitalisation rate, deferment rate or relativity, whilst enfranchisement premiums are meant to reflect the correct 'market value' for the landlord's asset, the current valuation methodology can give rise to a range of possible outcomes in respect of the same property. Therefore, provided that the Government prescribes rates which result in premiums that are within the range of possible outcomes under the current law (or are even towards the lower end of that range of possible outcomes), it would be difficult to argue that such rates have not been prescribed at market levels. If such a scheme is developed, I consider that the risk of a successful A1P1 challenge to this aspect of the scheme is Medium Low to Low.

82. It is more difficult to advise in relation to scenario (b), in the absence of knowing the primary objective/s of the scheme, the identity of the leaseholders who would benefit from the scheme, or the level of the resulting premiums. A rate intentionally prescribed to be marginally less than a market rate, or not significantly below a market rate (or the range of values which can be described as market levels), would not *ipso facto* be incompatible with A1P1. But clearly, the further away from a market rate (or the range of possible outcomes reflecting market levels) that the rate is prescribed, the higher the risk of a finding that the scheme as a whole does not strike a fair balance, and imposes a disproportionate burden on landlords.

<u>Treatment of ground rent</u>

83. The Law Commission intends to suggest to the Government that the ground rent to be taken into account in any enfranchisement valuation (when calculating the value of the term) could be capped at 0.1% of the property's value. This cap is on the basis that any ground rent above this level is now generally considered onerous. For many enfranchisement claims, this will make no difference to the calculation of the premium, as the ground rent will not be onerous. However, there will be some claims in which the ground rent used to determine the premium would otherwise be higher because it is

onerous. In these cases, the cap will deprive the landlord of a capital payment to compensate for the rental stream to which he or she would otherwise be contractually entitled (in so far as that rental stream would have exceeded 0.1% of the property's value).

84. The Law Commission understands that in the majority of these cases, the leaseholder will have paid a premium on the grant of the lease which is the same as the premium he or she would have paid if there were no onerous ground rent liability. Further, it understands that in many of these cases, the leaseholder was unaware of the onerous nature of the ground rent provisions. However, other consultees have suggested that there may be leases granted at reduced premiums to reflect the onerous nature of the ground rent provisions.

85. The Law Commission seeks my advice on the compatibility of the proposed cap in both of these scenarios, namely, where a lower premium was or was not paid.

86. In the scenario in which the leaseholder paid the same premium on the grant of the lease as he or she would have paid if there was no onerous ground rent liability, then in my view, the payment of onerous ground rent to the landlord is an undeserved windfall. I understand that ground rent generally bears no relation to the level of maintenance or the quality of service provided to leaseholders – that is the function of the service charge.[67] Therefore, where leasehold properties are sold for the same price as their freehold equivalents, the ground rent simply represents a source of income for landlords, with little to justify it beyond the fact that it was agreed as a term of the lease. Where the ground rent exceeds 0.1% of the property's value, it becomes disproportionate to the value of that property. For that same ground rent then to be factored into the calculation of the premium means that the landlord receives a further windfall when the leaseholder exercises his or her enfranchisement rights. In those circumstances, I consider that capping the ground rent at 0.1% of the property's value represents a fair balance between the landlord's contractual entitlement to receive some income and the rights of leaseholders, and is likely to be compatible with A1P1. The risk of a successful challenge to such a cap is likely to be Medium Low.

[67] See, for example, Housing, Communities and Local Government Committee *Leasehold Reform* (19 March 2019) at paras 80-83.

87. On the other hand, where the price paid for the leasehold property was reduced to reflect the onerous nature of the ground rent provisions, it may be harder to justify capping ground rent at 0.1% of the property's value. The landlord would have a basis for arguing, in this scenario, that he or she has foregone capital in return for a guaranteed source of income over the life of the lease, and that the rent in excess of 0.1% of the property's value is not in these circumstances a windfall. Nevertheless, as just one element of a scheme, it may still be possible for the Courts to find that capping ground rent at 0.1% of the property's value represents a fair balance between the interests of landlords and those of leaseholders and wider society. Whether the Courts will do so will depend on whether the other elements of the scheme and the scheme as a whole can be said to impose a disproportionate burden on landlords. However, taking this element by itself, I consider that it is more likely than not that imposing such a cap in these circumstances would not be compliant with A1P1, or in other words, that the risk of a successful challenge to such a cap in these circumstances is Medium High.

Development and other additional value

88. In some enfranchisement claims, usually in collective enfranchisement claims by leaseholders of flats, the premium may be increased to reflect the development potential of the premises being acquired (for example, to reflect the value of building further floors of flats on top of a block of flats). The default position is that the leaseholders must pay the landlord in respect of any development value. The Law Commission intends to suggest to the Government that, in order to reduce premiums payable in respect of development value, leaseholders could be given the entitlement to elect to accept a restriction on future development of the property. If the leaseholders subsequently decided they wished to develop the premises, they would pay a portion of any profit received on a subsequent development to the landlord.

89. The Law Commission seeks my advice on the compatibility of such a restriction on development value with A1P1.

90. In my view, enabling leaseholders to elect to take a restriction on development, so as to avoid paying development value, is likely to be compatible with A1P1. This option does not deprive landlords of an entitlement; it simply removes the conditions in which an entitlement would arise. If the enfranchising leaseholders subsequently decide that they want to develop, this option would ensure that landlords receive a portion of the profit.

Provided the landlords' share of any subsequent profit is no less than the amount the landlords would have received by way of development value at the date of the freehold acquisition, I can see no basis for any objection under A1P1. I assess the risk of a successful legal challenge to such an option as Low.

The General Approach: Possible Schemes

Option 1 in the Consultation Paper: Simple Formulae

91. At paragraphs 15.41 to 15.57 of the Consultation Paper, the Law Commission discusses the possibility of setting enfranchisement premiums by reference to a simple formula. Option 1A would set premiums by using a multiplier of ground rent. Option 1B would set premiums by using a percentage of capital value. The Law Commission's preliminary view is that such formulae, if of general application, would not be compatible with A1P1 for the reasons set out in those paragraphs of the Consultation Paper. I agree, and therefore deal with these options briefly.

92. Option 1A in the Consultation Paper: Multiplier of Ground Rent: Under this valuation method, the only factor that would be used to determine the premium is the ground rent. The ground rent figure itself may be an arbitrary amount which bears no relation to the capital value of the property. This means that the resulting premium on enfranchisement would be arbitrary. The valuation method would take no account of the reversionary value (which may be substantial) or the length of the lease. Consequently, a premium based solely on the ground rent is likely to be arbitrary, bear no relation to the value of the landlord's asset and be too inflexible to take account of differing situations. I consider that such a valuation method is unlikely to be compatible with A1P1, and I estimate the risk of a successful challenge to such a valuation method as High. It should be disregarded.

93. Option 1B in the Consultation Paper: Percentage of Capital Value: Under this valuation method, the premium would be set at a percentage of the capital value of the freehold. The premium would not reflect the length of the lease or any difference in the ground rent payable. It would therefore be equally as inflexible as a ground-rent multiplier. Depending on what percentage was set, it may result in higher premiums. I consider that such a valuation method is unlikely to be compatible with A1P1, and that the risk of a successful challenge to such a valuation method is High. It should also be disregarded.

Option 2 in the Consultation Paper: Options based on 'market value'

94. The Law Commission sets out a number of options based on market value. Its proposed approach in its report is to consider the assumed market in which the landlord's interest is being sold, in particular whether the leaseholder is assumed to be in that market either at the valuation date or in the future. The options can be summarised as follows:

    (1) Scheme 1 – under this option, it is assumed that the leaseholder is not in the market at the time the premium is calculated and will never be in the market. This produces a premium based on the value of the term and reversion only, and does not include any marriage value or hope value. It is similar to Option 2A in the Consultation Paper. This option would produce the greatest reduction in premiums for leaseholders with less than 80 years unexpired on their leases. For leaseholders with more than 80 years unexpired, it would, without more, make no difference to the premium payable;

    (2) Scheme 2 – under this option, it is assumed that the leaseholder is not in the market at the time the premium is calculated but may be in the market in the future. This produces a premium based on the value of the term and reversion, plus possibly hope value but no marriage value. This option was not put forward in the Consultation Paper. This option on its own would produce the second biggest reduction in premiums for leaseholders with less than 80 years unexpired on their leases. For leaseholders with more than 80 years unexpired, it would, without more, make no difference to the premium payable;

    (3) Scheme 3 – under this option it is assumed that the leaseholder is in the market at the time the premium is calculated. This produces a premium based on the value of the term and reversion and marriage value (where it exists) and is, in effect, the same as Option 2C in the Consultation Paper. This option on its own would not reduce premiums for leaseholders because it reflects the current valuation regime.

95. Crucially and in contrast to the Consultation Paper, all of these schemes could include the payment of development or other additional value or compensation. However, any such additional value or compensation would be assessed applying the relevant assumption (i.e. as to whether the leaseholder was or ever would be in the market).

96. The Law Commission seeks my views of the compatibility of these three schemes with A1P1.

97. Scheme 1: If it is assumed that the leaseholder is not in the market and will never be in the market, then the 'market value' of the landlord's interest is simply the value of the term and reversion. If the lease ran its course and the leaseholder never chose to extend it or acquire the freehold, the landlord would get nothing more than the ground rent throughout the term of the lease and vacant possession upon its expiry i.e. the value of the term and reversion. This assumption would mirror that scenario. It would reduce premiums where the current lease has less than 80 years unexpired. But according to the Law Commission, the scheme still produces a market value because there is no guarantee that a leaseholder will ever enfranchise – the lease might just run its course.

98. In my view, the question of whether this option is compatible with A1P1 is fairly finely balanced. Marriage value comprises the additional value an interest in land gains when the landlord's and the leaseholder's separate interests are 'married' into single ownership. The aggregate value of those two interests held separately is often significantly less than the value of both where both are held by the same person. The analogy often used is that of a pair of Chinese vases: the vases are worth more as a pair than the sum of their individual values if owned separately. The additional value, where they are owned as a pair, is equivalent to marriage value. Marriage value can make a significant difference to the premium payable, as evident from the calculations in Figures 14 and 15 of the Consultation Paper. The shorter the lease (below the 80-year cut-off), the greater will be the marriage value. The effect of this scheme will therefore be to deprive landlords of a significant portion of what they otherwise would have received where a leaseholder acquires the freehold or extends the lease. Therefore, this scheme does not reflect the true market value where the leaseholder is in the market.

99. On the other hand, although the leaseholder under this scenario will gain the enhanced value from marrying the freehold and leasehold interests, arguably, the landlord loses nothing under this scenario. The value payable to the landlord reflects the minimum that a third-party investor would pay the landlord to purchase his or her interest (without any hope that the leaseholder would acquire the freehold or extend the lease in future). It is the equivalent of smashing the leaseholder's vase, so far as the landlord is concerned: the

landlord still holds his or her vase, but there is no additional value referable to the possibility of it being reunited with its pair. It is, in this sense, still a 'market value', just a market in which a special purchaser (i.e. the leaseholder) does not exist and the lease simply runs its course.

100. Ultimately, this issue is unlikely to turn on semantics as to whether this option results in a premium that reflects 'market value'; on any view, the landlord will be deprived of at least part of the premium that otherwise would have been paid by the enfranchising leaseholder. The question will ultimately turn on whether the UK or Strasbourg Courts would regard this reduction in compensation as upsetting the fair balance between landlords' interests and those of general society, and whether it will result in landlords shouldering an excessive burden. This will ultimately depend on the strength of the public interest or interests at stake. If the aim of the legislation is the wholesale reform of UK property laws affecting leasehold enfranchisement, and deliberate re-distribution of wealth from one part of society to another, then the Courts are likely to be more willing to conclude that the legislation strikes a fair balance, despite the reduction in compensation. It would be possible to distinguish between legislation based on this option, and the impugned measure in Lindheim, under which the compensation payable to lessors bore little relation to any form of market value and where the compulsory lease extension was for an indefinite duration.

101. I can also see that there would be strong practical reasons for adopting this scheme. Calculation of marriage value is complex and controversial. If marriage value were no longer payable, the need to calculate relativity (or a deduction for Act rights) would fall away. This would also have the knock-on effect of reducing professional fees.

102. The risk of a Court finding that this option violates A1P1 would also be reduced if the option includes development or additional value (albeit that any such value would also be assessed on the assumption that the leaseholder was not and would never be in the market). The example provided by the Law Commission in its written instructions to me is that of a freehold interest which includes a basement, which could be developed by incorporating it into an existing ground floor flat or by creating a separate lower ground floor flat. If there was an assumption that the ground floor leaseholder was not and would never be in the market, then any development value which could only be realised by

granting a lease of the basement to the leaseholder could not be taken into account, but development value which could be realised by independently developing the basement could be. This value would be calculated by reference to what a hypothetical third-party purchaser of the freehold interest would pay the current freeholder, in addition to the value of the term and reversion, for the potential to develop the basement in the future. In this example, the freeholder would receive something on enfranchisement in respect of development value, even though this might be less than would be paid at present.

103. Without knowing the final shape of legislation based on this option, it is difficult to advise on prospects of a successful A1P1 challenge. However, if the aim of the legislation is the wholesale reform of UK property laws affecting leasehold enfranchisement and the option were to include development or additional value, then on balance, I consider that it is marginally more likely than not that the option would be compliant with A1P1. In other words, the risk of a successful A1P1 challenge to this option is slightly less than 50% i.e. towards the upper end of Medium Low.

104. Scheme 2: If it is assumed that the leaseholder is not in the market, but may be in the market in the future, then the 'market value' of the landlord's interest is the value of the term and reversion, plus potentially an amount to reflect the hope of doing a deal with the leaseholder in the future. This is what the landlord would receive in the open market, if the landlord's interest was sold to an investor as opposed to the leaseholder. As the investor would not be a special purchaser, no marriage value would be realised on the sale to the investor. However, the investor would anticipate the possibility of releasing marriage value by a sale to the leaseholder in the future, and may pay something in addition to the value of the term and reversion to reflect the hope of this happening. This scheme would reduce premiums where the current lease has less than 80 years unexpired, but not to the same extent as in Scheme 1 above. Further, it would not reduce the premium on a collective enfranchisement in so far as it relates to the leases of any non-participating leaseholders who have less than 80 years left to run because hope value is already payable in respect of such leases (see para 14.69 of the Consultation Paper). According to the Law Commission, this scheme therefore produces a 'market value'; it is the market value which would be paid by an investor.

105. I consider that it is more likely than not that this option is compatible with A1P1, although it remains reasonably finely balanced. The risk of a successful A1P1 challenge is lower than it would be for Scheme 1 because the premium payable is closer to the amount that the landlord would receive if the leaseholder was in the market, and is therefore closer to the true 'market value' in the circumstances of leaseholder enfranchisement. Again, the risk of a Court finding that this option violates A1P1 would also be reduced if the option includes development or additional value. In this scenario, the development value would be calculated by reference to what an investor would pay the landlord for the prospect of doing a deal with the leaseholder in the future (which would be less than the development value in the hands of that leaseholder, as a discount would need to be applied to reflect the risk that the leaseholder may never seek to do a deal). On balance, I consider that the risk of a successful A1P1 challenge under this option is Medium Low.

106. Scheme 3: The assumption that the leaseholder is always in the market leads to a premium which includes the value of the term and reversion, as well as marriage value, where it exists. Applying this assumption to development and other additional value means that value in the hands of the leaseholder can be considered, whether or not he or she chooses to realise it.[68] This scheme, on its own, would not reduce premiums for leaseholders. As a result, this scheme is highly likely to be compatible with A1P1 as it most closely resembles the current valuation methodology. The risk of a successful challenge to this valuation method is Low.

Section 9(1)

107. Section 9(1) of the 1967 Act applies to the right to purchase the freehold of a house in some instances. The absence of marriage value and the fact that any reversionary value is deferred for an additional 50 years without the payment of a premium but upon the payment of a rent which assumes there is no building on the site makes section 9(1) the most favourable basis of valuation for leaseholders. I understand that outside of London, many leasehold houses qualify for a section 9(1) valuation, particularly in areas such as the Midlands and South Wales. In London, particularly Prime Central London,[69] houses which qualify for a section 9(1) valuation are relatively rare.

[68] See Padmore v Barry and Peggy High Foundation [2013] UKUT 646 (LC), in which the Upper Tribunal held that the value of the landlord's interest included marriage value, even though the leaseholder did not intend to undertake any development to realise that value.
[69] As defined in the Glossary to the Consultation Paper.

108. Understandably, the Law Commission considers that the section 9(1) basis of valuation would not be suitable to be adopted as the single valuation method for all enfranchisement claims because of the problems identified with it in Chapter 14 and paragraph 15.20 of the Consultation Paper. The rationale underpinning the introduction of the original valuation basis in section 9(1) is no longer applicable. In addition, there are real difficulties ascertaining which properties qualify for valuation under section 9(1), the qualification criteria can be irrational as they no longer accurately capture all or only low value houses, and there are a number of problems with calculating the premium payable under section 9(1). Conversely, if section 9(1) was abolished, either with immediate effect or following a sunset period, premiums would be significantly increased for a great many leaseholders of houses who currently qualify for the more favourable valuation basis under section 9(1). This would be contrary to the Law Commission's Terms of Reference.

109. Given the complexity of the current law, the Law Commission's view is that it would be desirable to replace section 9(1) with an equivalent but simplified provision, if this is possible.

(1) In terms of replacing the current qualification criteria (which are based largely on historic rateable values), the Law Commission has considered three alternative replacement qualification criteria: Council Tax banding, the Find R test, and capital value. However, it has found that none of the alternatives would ensure that all and only those houses that currently qualify for a favourable valuation would continue to do so under the replacement provision. Some houses which now qualify for a valuation under section 9(1) would no longer qualify under the replacement provision, and vice-versa.

(2) The Law Commission has proposed various measures to reduce the impact on leaseholders and landlords of introducing replacement qualification criteria that do not replicate the results produced by the current qualification criteria. In particular, the Law Commission has suggested that the current provisions of the 1967 Act which relate to qualification under section 9(1) would remain in force for a period of five years following the passing of any new Act, so leaseholders who would currently benefit from a section 9(1) valuation but would not benefit from

its replacement would have the opportunity to take advantage of section 9(1) for a limited period (a sunset provision). The Law Commission has also suggested limiting the number of landlords affected by the change by limiting qualifying properties to houses only (or mostly houses), and by limiting qualifying properties to existing leases of existing properties.

(3) In terms of valuation methodology, the Law Commission has proposed replacing the current methodology with a simplified methodology based on the value of the term of the lease (the capitalised ground rent) plus a percentage of its reversionary value, which should be the same percentage as that currently used to determine site value (for example, 50% in London, and 35% in South Wales). This method would produce premiums which are similar in amount to those currently produced under section 9(1), but which are not identical. The Law Commission would suggest prescribing certain rates to increase the simplicity of the new methodology, including deferment and capitalisation rates.

110. The Law Commission seeks my advice on the compatibility with A1P1 of replacing the current qualification criteria for section 9(1) as set out above, and of replacing the valuation methodology as set out above, given that the results will not be identical to those produced under the current system.

111. The section 9(1) basis of valuation is somewhat of an historical anomaly. If it were to be introduced now, it may well be considered to violate A1P1. However, it has previously been held to be lawful, and its lawfulness was not subsequently challenged on the abolition of the residence requirement, and the expansion of the categories of leaseholder who may benefit from it to include corporate bodies and/or investors. Leaseholders and landlords have conducted their affairs for over 30 years on the basis that the section 9(1) basis of valuation is lawful. Given that retaining section 9(1) cannot be unlawful, it is therefore unlikely that replacing section 9(1) with an equivalent but simplified provision would be unlawful.

112. However, that assessment depends on any simplified replacement provision being equivalent to section 9(1) both in terms of who would qualify to benefit from the replacement basis of valuation and in terms of the amount of the premium payable. In my view, the guiding principle should be that landlords should be no worse off under a

replacement provision than they already are under section 9(1). That is because section 9(1) represents the outer limits of compatibility with A1P1. The further that a replacement provision moves away from the current qualifying criteria and the premiums currently payable under section 9(1), the greater the likelihood that the replacement provision would be assessed by the Courts on its own merits (rather than simply being viewed as equivalent to section 9(1)) and held to be incompatible with A1P1.

113. In fact, it does not appear to be possible to identify a simple test which would mirror the current qualification criteria. This gives rise to two risks. First, there is the litigation risk that there will be landlords of properties which do not currently qualify for a valuation under section 9(1) but which would be brought within the scope of any replacement provision, who will therefore be incentivised to challenge the compatibility of the replacement provision with A1P1. Second, there is the risk that the replacement qualification criteria will be found to be irrational or arbitrary on their own terms and/or which fail to achieve their designed purpose of replicating the section 9(1) qualification criteria.

114. For example, I understand that there is no apparent correlation between Council Tax banding and the properties to which section 9(1) currently applies. Further, there appears to be little correlation between Council Tax bands and current property values. Consequently, it does not appear that Council Tax bands could be used reliably to identify houses which could today be described as "low value". Given that the original rationale for section 9(1) was to grant enfranchisement rights to leaseholders of low value houses only, there is a risk that a purported replacement for section 9(1) based on Council Tax bands will capture houses which would not have been caught by section 9(1) and which could not be regarded as low value and will therefore beheld to be irrational or arbitrary and in breach of A1P1. I assess such a risk as Medium High.

115. The risk of qualification criteria based on the Find R test and capital value being held to be irrational or arbitrary is probably lower because they are at least designed to capture low value properties, but I do not know whether there are any other problems with these tests which may make it difficult or impossible to draw principled distinctions between the properties caught within the scope of any replacement provision and those left outside it.

116. The introduction of a sunset provision for section 9(1) is unlikely to change the risk assessment above. A sunset provision in itself is not problematic from an A1P1 perspective. It is designed to provide some protection for existing leaseholders for a time-limited period, without at the same time preventing ultimate reform of current valuation provisions. However, it does not address the problem identified above, namely, that landlords will be brought within the scope of a replacement provision who do not currently qualify for a valuation under section 9(1). Further, it will not save replacement qualification criteria which are otherwise irrational or arbitrary from being held incompatible with A1P1.

117. I consider that, as a minimum, it will be necessary to limit qualifying properties to houses only or to residential units that qualify for an 'individual freehold acquisition' (which will have the effect of limiting the ambit of the replacement section 9(1) mostly to houses). This will at least reduce the number of landlords affected by the change. But as I understand it, even with this mitigating measure in place, there would still be properties which do not currently qualify for a valuation under section 9(1) but which will qualify under the replacement criteria, where it would be open to the landlords to argue that the criteria themselves are irrational or arbitrary. If such qualification criteria are irrational or arbitrary, the number of landlords affected will not change the assessment that the criteria are incompatible with A1P1.

118. I do not consider it would assist to limit the replacement section 9(1) provision to existing leases of existing properties. In fact, it would introduce a further disparity, which may be hard to justify, in that leaseholders of existing leases would pay less to purchase their freeholds than leaseholders of new leases of exactly the same value.

119. In terms of the replacement valuation methodology, I understand that the Law Commission's proposed methodology would produce premiums which are more similar in amount to those currently produced under section 9(1), since it more closely resembles the current valuation methodology and will take more account of regional variations in value. However, I also understand from modelling produced by Gerald Eve and the Law Commission that the premiums produced by the replacement provision would not be the same as those produced by the current section 9(1) methodology, and that there will be some cases in which the leaseholder will pay (and the landlord will receive) slightly more

than currently and some cases in which the leaseholder will pay (and the landlord will receive) significantly less (i.e. up to 16% less).

120. In my view, in the context of valuation methodology (as opposed to qualification criteria), compatibility with A1P1 is likely to depend on the number of landlords who receive considerably reduced premiums in the event the valuation methodology was replaced. If very few landlords would be affected by the reduced premiums, then the Court is more likely to take the view that landlords as a group are not being made to bear an excessive burden; if, however, large numbers of landlords would be affected, the Court is more likely to conclude that the replacement valuation methodology does not strike a fair balance between the rights of landlords and the general interests of society (including leaseholders).

121. The Law Commission has also suggested prescribing rates to increase the simplicity of any replacement valuation methodology. I address the compatibility of prescribing rates in paragraphs [77] to [82] above. In my view, the same principles apply to considering the compatibility of prescribing rates in the context of a replacement valuation methodology for section 9(1) as apply to prescribing rates under the general approach, save that the rates prescribed under a replacement section 9(1) should not result in the payment of premiums that are lower than currently produced under section 9(1), in line with the guiding principle that landlords should be no worse off under a replacement provision than they already are under section 9(1).

122. An alternative to replacing section 9(1) would be to retain it in its current form indefinitely, as an exception to the general approach to valuing the premium. Whilst an unattractive proposition for a number of reasons, it would avoid the difficulties resulting from the lack of any simplified but truly equivalent provision to replace section 9(1), and it would avoid any issue in respect of A1P1.

123. If the current valuation methodology under section 9(1) is retained, the Law Commission has suggested prescribing rates (including capitalisation and deferment rates) to simplify the current position and enable the use of an online calculator. The Law Commission seeks my advice in relation to that suggestion. Again, in my view, the same principles apply to considering the compatibility of prescribing rates in the context of retaining section 9(1) in its current form as apply to prescribing rates under the general

approach, save that the rates prescribed under section 9(1) should not result in the payment of premiums that are lower than currently produced under section 9(1) in line with the guiding principle that landlords should be no worse off than they already are under section 9(1).

124. The Law Commission has also suggested abolishing section 9(1) and introducing an entirely new scheme which is designed accurately to apply to all low value properties (and exclude higher value properties), and which provides leaseholders of low value properties with a more favourable basis of valuation. The Law Commission has observed that section 9(1) was originally designed to apply only to low value properties but no longer fulfils this purpose as there are houses which were low value historically but are now very valuable, yet enjoy the section 9(1) valuation basis (and vice-versa). Such a scheme may look very similar to the proposals the Law Commission has made for replacing section 9(1) in relation to qualification criteria or valuation methodology. However, such a new scheme would be qualitatively different from the schemes suggested as replacements for section 9(1) because the aim of the scheme would not be to try to introduce a simplified equivalent provision, but to give leaseholders of low value properties (both houses and flats) additional assistance to enable them to purchase their freeholds.

125. The Law Commission has suggested two main options for the way in which such a scheme could be introduced: first, by abolishing section 9(1) and introducing the new scheme with immediate effect; or second, by retaining section 9(1) in its current form for existing leases either temporarily (for a sunset period of, for example, five years) or indefinitely (which would equate to a slow abolition), while applying the new scheme only to newly granted leases of existing properties or newly built leasehold properties. The Law Commission envisages the two schemes (section 9(1) and the new scheme) would run alongside each other for as long as section 9(1) remained in force. The rationale for retaining section 9(1) either temporarily or indefinitely for existing leases would be to ensure that premiums would not immediately increase for leaseholders who currently qualify under section 9(1), when the new scheme is introduced.

126. The Law Commission seeks my advice on whether the introduction of a new scheme of the type set out above could be compatible with A1P1, and which (if any) of the methods for introducing the scheme would be preferable in terms of compatibility with A1P1.

127. In my view, different considerations would apply in terms of compatibility with A1P1 if the Government's purpose in introducing such a new scheme was the creation of a more accurate method of identifying lower value properties and providing leaseholders of such properties with a more favourable basis of valuation, rather than the Government's purpose being to simplify the complexities of section 9(1). If the Government made the assessment (supported by evidence) that leaseholders of low value properties require additional assistance to enable them to enfranchise (for example, because they are less likely to be able to afford to enfranchise even in respect of a low value property), and the Government's aim in introducing the scheme was to assist such leaseholders to enfranchise, then the Courts are likely to find that the scheme pursues a legitimate aim in the public interest (as the ECtHR did in James v UK). Provided the scheme accurately applies to all and only low value properties, it would be impossible to attack the scheme as arbitrary, irrational or as failing to achieve its designed purpose. The only question would be whether it strikes a fair balance in terms of compensation payable to landlords. If the premiums payable to landlords under the new scheme are no lower than those currently payable under section 9(1), then I consider that any such new scheme is marginally more likely than not to be compatible with A1P1. In other words, I would assess the risk of a successful A1P1 challenge to such a scheme as slightly less than 50% i.e. towards the upper end of Medium Low.

128. The A1P1 risk assessment is unlikely to be significantly affected by the manner in which the new scheme is introduced. What is likely to matter more is whether Parliament takes sufficient time to consider the aims and ambit of the scheme and particularly to consider the impact of the scheme on landlords (as well as leaseholders). I consider it would be open to the Government to abolish section 9(1) and introduce the new scheme with immediate effect, without affecting the A1P1 risk assessment. I also consider it is unlikely to affect the risk assessment to retain section 9(1) for a temporary period, at the same time as introducing the new scheme. Although this would introduce a disparity between leaseholders of existing and new leases which are of equal value, this would be temporary, and could probably be justified on the basis that it would allow leaseholders who currently qualify for a section 9(1) valuation but would not qualify under the new scheme (or who qualify under both section 9(1) and the new scheme but would have to pay an increased premium under the new scheme) the opportunity to take the benefit of section 9(1) while it remained in force.

129. However, I have more concern about any proposal to retain section 9(1) indefinitely alongside a new scheme. This would appear to have less justification than a sunset provision, as it would create a long-term disparity between leaseholders of existing and new leases which are of equal value for no obvious reason. It is also likely to increase the risk of a successful challenge to the section 9(1) basis of valuation, because it is harder to justify retaining a potentially flawed scheme indefinitely alongside a new scheme which was intended to remedy those flaws. I estimate that the risk of a successful A1P1 challenge in these circumstances would be Medium High.

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30 NOVEMBER 2019