The right to participate: the issues, possible solutions and remaining difficulties

INTRODUCTION

1.1 In the Enfranchisement Consultation Paper ("the Consultation Paper"),¹ we proposed the introduction of a new "right to participate", which would enable all leaseholders who did not participate in a collective freehold acquisition claim (for whatever reason), as well as those who have only since become qualifying leaseholders, to purchase a share of the freehold interest held by those who did participate. This proposal was intended to address the fact that, routinely, not all eligible leaseholders in a building will be invited to join in a proposed collective freehold acquisition claim, or will be able to participate at that time.²

1.2 In Chapter 5 of the Enfranchisement Report ("the Report"),³ we explained that, despite widespread support amongst consultees for the right to participate, we are not able to recommend the introduction of such a right at this time. Although we maintain that the introduction of the right to participate would, in principle, be desirable, we have identified a number of important questions which would need to be resolved in order for the right to participate to operate satisfactorily. We think that these questions require separate and detailed consideration. We also agree with suggestions from consultees that further work on the right to participate might usefully include further consultation with stakeholders. We have advised that we would welcome discussions with government around when and how this work might be carried out.⁴

1.3 As part of our work to date, we have given considerable thought to the issues we have identified and how they might be resolved. In this note, we first set out some general principles which we consider should underpin the operation of the right to participate, before addressing each of these issues. We set out our current thinking, including any solutions we have identified, and the difficulties which remain.

GENERAL PRINCIPLES

1.4 The aim of the right to participate is to increase the ability of leaseholders to participate in the ownership and management of their buildings. The right should address the fact that, under the current law, a leaseholder who has not participated in a collective freehold acquisition claim (for whatever reason) has no means to require the participators to allow him or her to join in the ownership and management of the building at a later date. We also hope that the introduction of such a right will encourage leaseholders to invite others to participate in the original claim, thereby

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¹ Leasehold home ownership: buying your freehold or extending your lease (2018) Law Com No 238.
² See CP, paras 6.144 to 6.159.
³ Leasehold home ownership: buying your freehold or extending your lease (2020) Law Com No 392.
⁴ See the Report, paras 5.222 to 5.246.
indirectly addressing the fact that, at present, some leaseholders may be excluded from a collective freehold acquisition claim which their neighbours are planning.

1.5 There are several principles which we think should underpin the right to participate:

(1) The exercise of the right to participate should put the leaseholder exercising the right (who we will refer to as the “RTP leaseholder”) in the position he or she would have been in had he or she participated in the original collective freehold acquisition claim, in so far as that is possible. The aim should be to give the RTP leaseholder the same key benefits that accrue to the original participating leaseholders: a share in the ownership of the freehold of the relevant building(s), and a vote on management issues.

(2) The right to participate should not, however, extend to a right to share in any benefit deriving from any “investment” element of the original collective freehold acquisition transaction – in other words, where development value or hope value which formed part of the premium paid by the original participants is later realised. The purpose of the enfranchisement regime is not to provide an investment opportunity. It is impossible to say what the parties might have agreed had the RTP leaseholder been an original participant in the acquisition. We discuss this further at paragraph 1.44(1) below.

(3) The premium payable and terms governing the right to participate should take into account the fact that the RTP leaseholder did not participate at the time of the original collective freehold acquisition claim (whatever the reason for that may have been). Not to do so could be unfair to the original participants or could act as a disincentive to participation in the original acquisition. We discuss this further at paragraph 1.43 below.

(4) The right should be available to any leaseholder for the time being of a residential unit (who meets the criteria for the exercise of enfranchisement rights). In other words, a leaseholder whose predecessor in title did not participate in a collective freehold acquisition claim would be able to exercise the right. We see no reason why the right should be restricted to those who were leaseholders at the time of the original collective freehold acquisition claim – if anything, a successor in title has a better reason for not having participated in the original claim.

1.6 Importantly, we also think that the right to participate needs to strike a careful balance. On the one hand, we want to make sure that the right to participate is an attractive, valuable and workable right for leaseholders who choose to exercise it. But on the other hand, facilitating the right to participate must not have the effect of making a collective freehold acquisition claim much less appealing in the first place – such as by detracting from what it means for leaseholders who do make a such a claim to own their freehold. Similarly, it is important that the existence of the right to participate does not disincentivise individual leaseholders from participating in the original

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5 “Development value” is the value to the owner of land of the ability to develop that land (for example, in the case of a block of flats, by building a further floor of flats on the roof). “Hope value” is an amount of money payable as part of the premium in a collective enfranchisement claim in respect of non-participating flats, to reflect the fact that the leases of those flats may be extended (at a premium) in the future.
collective freehold acquisition claim, on the basis that they can always exercise the right to participate later. These are themes to which we return throughout the remainder of this note.

THE BASIC OPERATION OF THE RIGHT TO PARTICIPATE

1.7 We explained in the Consultation Paper that the right to participate might be possible because of our provisional proposal that leaseholders making a collective freehold acquisition claim should be required to use a company as the nominee purchaser. This would enable a leaseholder who did not participate in the claim to “join in” the ownership and management of the building at a later date, by acquiring membership of the nominee purchaser company. We felt that it would be much more difficult to facilitate the right to participate where the freehold title is held in the names of individuals following the collective freehold acquisition. We made a further provisional proposal that the company should be a company limited by guarantee, which we felt would be the easiest for leaseholders to administer.

1.8 Next, we explained our view that it would be necessary for the articles of a nominee purchaser company to be prescribed in order to facilitate the right to participate. The articles of association represent the terms on which the RTP leaseholder will acquire membership of the nominee purchaser company (and, thus, a share of the freehold interest in the premises acquired). As such, the articles must be fair to the RTP leaseholder. For example, the right to participate would be rendered illusory if the original participants could set up a company with articles providing that anyone seeking to join the company subsequently must pay a membership fee of £1,000,000. Equally, it would be necessary to ensure that the articles could not be changed by the original participating leaseholders once the collective freehold acquisition has been completed but before anyone has exercised the right to participate.

1.9 For those reasons (and others), we provisionally proposed that the articles of association of the nominee purchaser company must contain certain prescribed articles. We also proposed that it should not be possible to depart from those prescribed articles for so long as there are non-participating leaseholders (or potential future leaseholders) who may seek to exercise the right to participate in the future. In other words, it would only be permissible to depart from those prescribed articles where all of the residential units within the premises being acquired are held on long leases, and the leaseholders of all of those units are already members of the nominee purchaser company.

1.10 In the Report, following consultation, we have recommended that a collective freehold acquisition claim should be carried out using a corporate body with limited liability as the nominee purchaser. There are good reasons for a corporate body to be used, beyond that it would facilitate the operation of the right to participate. It would also provide clarity surrounding beneficial ownership of the premises, aid efficient day-to-

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6 See CP, paras 6.61 to 6.67 and 6.154.
7 See CP, paras 6.69 to 6.79.
8 See CP, paras 6.80 to 6.81 and 6.156(2).
9 See CP, paras 6.82 to 6.87.
day management of the premises by enabling decision-making by appointed directors, and avoid the need to execute a conveyance of the freehold title to the premises each time a flat within the premises is sold to ensure that the incoming leaseholder also acquires a share in the freehold. However, we have not recommended that a particular form of corporate body must be used, despite our provisional proposal that it should be a company limited by guarantee. We were persuaded by those consultees who argued that different groups of leaseholders may wish to use different structures – such as companies limited by shares, limited liability partnership and certain co-operative structures – to accommodate their own particular circumstances and preferences.

1.11 It is for similar reasons that we have not recommended that prescribed articles must be used by all nominee purchaser corporate bodies. Numerous consultees felt that prescribed articles would restrict consumer choice and may not cater adequately for the varying circumstances of buildings acquired via collective freehold acquisition. We were persuaded by the desirability of ensuring flexibility for leaseholders making a collective freehold acquisition claim. After all, the purpose of collective freehold acquisition is to give leaseholders control over their own homes and how they are managed.

1.12 Accordingly, our recommended approach to the operation of the right of collective freehold acquisition does not lend itself well to the introduction of the right to participate. In particular, we remain of the view that if the right to participate is to operate successfully, it will be necessary for nominee purchaser corporate bodies to use prescribed articles. In other words, the way in which the right of collective freehold acquisition is to be exercised will need to be more closely prescribed, perhaps in a way which could make the right less appealing to some leaseholders. This tension between flexibility for leaseholders making a collective freehold acquisition claim and the desire to protect the position of leaseholders who may exercise the right to participate in the future underpins many of the issues discussed further below.

WHEN AND TO WHOM SHOULD THE RIGHT TO PARTICIPATE BE AVAILABLE?

1.13 In the Consultation Paper, we said that the right to participate should be available wherever there has been a successful collective freehold acquisition claim. On further consideration, we now recognise that it may not always be straightforward to identify where this is the case – as we discuss at paragraphs 1.54 to 1.57 below. But even where there can be no doubt that a collective freehold acquisition claim has taken place, there are a number of questions as to when and to whom the right to participate should be available.

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10 See the Report, paras 5.52 to 5.59.
11 Instead, we have recommended that an optional model constitutional document should be produced for each type of corporate body which might be used as the nominee purchaser on a collective freehold acquisition claim, which we hope many groups of leaseholders will make use of. See the Report, paras 5.63 to 5.68.
Should the right to participate apply to claims which were made before the right is introduced?

1.14 We noted in the Consultation Paper that it is questionable whether the right to participate should be available in respect of collective enfranchisements which have taken place under the existing enfranchisement legislation. Such transactions will not necessarily have been carried out by a nominee purchaser which is a corporate body, and almost certainly not by one with articles of association which would facilitate the right to participate. The same question would arise in respect of collective freehold acquisition claims which have completed under our recommended regime but without using prescribed articles, given our decision not to recommend a set of prescribed articles for use by nominee purchasers for the time being.

1.15 We remain of the provisional view that it would be very difficult, if not impossible, to ensure that the right to participate is available in respect of transactions other than those which take place under a new regime specifically designed to facilitate the future operation of the right. However, we are conscious that the vast majority of consultees who expressed a view on this question felt that the right should be available in respect of previous claims. These consultees were concerned that restricting the right to participate to future claims would be unfair to leaseholders in blocks where there has already been a successful collective enfranchisement claim and who would therefore have no means of acquiring a share in their freehold (save by organising a fresh collective freehold acquisition claim). Some consultees thought this could lead to the creation of a two-tier market, with greater value being attributed to leases in blocks where there has not yet been a collective freehold acquisition claim compared to those in blocks where a claim has already taken place. We also recognise that there will be many earlier claims which were carried out via a nominee purchaser which is a corporate body, and in respect of which it might be possible to exercise the right to participate, but which would be excluded if the right were restricted to future claims.

1.16 Overall, in light of consultees’ views, we think that it would be unfair at this stage to preclude the operation of the right to participate in respect of collective enfranchisement or collective freehold acquisition claims which complete prior to the introduction of any new regime designed to facilitate the operation of the right to participate. Whilst our provisional view is that enabling the right to participate in these scenarios is likely to be challenging, we think that further work is required to consider whether there is a way in which it might be accommodated, at least in some cases.

Which leaseholders will qualify for the right to participate?

1.17 We think that the right to participate should be available in respect of any residential unit let on a long lease within premises which have been the subject of a collective freehold acquisition claim, provided that (as a general rule) no leaseholder of that unit either participated in that claim or has exercised the right to participate since. The right to participate should be available to the most inferior long leaseholder of that unit – that is, where there is a chain of leaseholders, the right to participate would be available only to the leaseholder at the bottom of the chain. This accords with the
general principle that it is the most inferior long leaseholder of any residential unit who is entitled to exercise enfranchisement rights.\textsuperscript{12}

1.18 Applying the above principles is straightforward in most cases. The right to participate will be available to:

\begin{enumerate}
\item a leaseholder who was eligible to participate in the collective freehold acquisition claim but did not do so (for whatever reason);
\item a leaseholder who purchases the lease of an eligible, non-participating leaseholder (provided the non-participating leaseholder has not in the meantime exercised the right to participate themselves);
\item a leaseholder who takes a long sub-lease from an eligible, non-participating leaseholder (again, provided the non-participating leaseholder has not yet exercised the right to participate themselves); and
\item the leaseholder of a new long lease granted over a unit within the premises acquired by collective freehold acquisition, where that unit was not previously the subject of a long lease;
\end{enumerate}

in each case provided that leaseholder has not themselves granted a long sub-lease of the residential unit.

1.19 However, a number of more difficult questions remain.

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\item First, it is unclear to us what should happen where a long leaseholder sells his or her lease or grants a long sub-lease \textit{after} he or she has exercised the right to participate (or indeed after he or she has participated in a collective freehold acquisition claim). We think that in the case of a sale, it would be expected that the outgoing leaseholder would also transfer his or her share in the nominee purchaser company to the incoming leaseholder as part of the transaction. But this might not necessarily happen, and may be considerably less likely to happen in the case of a sub-lease.

There is an argument that in these situations, the incoming leaseholder or sub-lessee should have some means to insist upon being able to participate in the ownership and management of the freehold. He or she will, after all, be the leaseholder who is entitled to exercise other enfranchisement rights – including the right to bring another collective freehold acquisition claim, should it be possible to motivate sufficient other leaseholders to make such a claim. It might be possible to provide that the outgoing or superior leaseholder's share in the nominee purchaser company should be passed to an incoming leaseholder or sub-lessee (whether automatically, or via an obligation on the outgoing/superior leaseholder to make the transfer). Alternatively, these leaseholders might be entitled to exercise some sort of modified right to participate as an exception to the general rule above that the right may be exercised only once in respect of a residential unit. We do not think it would be appropriate to allow these

\textsuperscript{12} See paras 13.9 to 13.15 of the Report for a fuller explanation of chains of leasehold interests and the availability of enfranchisement rights.
leaseholders to acquire a new share in the nominee purchaser company, as this would result in two shares having been issued in respect of the same unit, but they might be entitled to acquire the share held by their predecessor in title or landlord (as the case may be).

On the other hand, there is no provision under the current law, or under our recommended regime, for the share of the freehold interest belonging to a leaseholder who has participated in a collective freehold acquisition claim to be transferred automatically to that leaseholder’s successor in title or sub-lessee. Nor is there any power for a successor in title or sub-lessee to call for that share to be transferred to him or her. Such a transfer will either be agreed between the parties, or it will not. The suggestions above are therefore an example of adaptations which might be required to the usual collective freehold acquisition regime in order to accommodate the existence of the right to participate.

(2) Second, it will be necessary to decide whether the right to participate should be available where new units are created out of the freehold acquired by collective freehold acquisition (either because new units have been built, or an existing unit has been split in two). There are several options.

(a) The right to participate could be limited to long leases which existed at the time of the collective freehold acquisition, so that the leaseholders of new units do not have a right to participate. But this is likely to be considered unfair to the leaseholders of new units, and runs the risk that leases of such units are considered undesirable.

(b) The grant of new long leases out of a freehold title which was acquired via a collective freehold acquisition could be prohibited without an accompanying grant of membership of the nominee purchaser company. This would mean that the new leaseholder automatically obtains a share in the nominee purchaser. But this approach would amount to a limitation on the normal ability of a freeholder to grant long leases out of his or her freehold title.

(c) The leaseholder of a new unit could be permitted to exercise the right to participate in the same way as leaseholders who were eligible to participate in the collective freehold acquisition claim. However, this option may raise complex valuation issues, given that the premises now contain a different number of units from the number which existed at the time of the original collective freehold acquisition.

(3) Third, there is the question of what should happen where a long lease belonging to a leaseholder who participated in a collective freehold acquisition or exercised the right to participate has come to an end – whether by forfeiture, surrender or effluxion of time. In this situation, a new long lease might be granted to a third party. We do not think it would be possible simply to allow the new leaseholder to exercise the right to participate in the usual way. That would likely result in two shares having been issued in respect of the same unit, since the former leaseholder will still hold his or her share in the nominee purchaser company. One option might be to make provision for a leaseholder’s share in a nominee purchaser company to revert to the company if his or her lease...
determines, so that it can be granted along with a new lease, or will be available to be granted to the new leaseholder if they choose to exercise the right to participate. Another might be to provide (as at paragraph 1.19(1) above) for the former leaseholder’s share in the nominee purchaser to be transferred to the leaseholder under the new lease of the relevant flat (whether automatically, or via an obligation on the original leaseholder to make the transfer).

1.20 We think that further engagement with stakeholders is necessary to resolve these questions.

Can the right to participate be exercised by former landlords who have taken a leaseback?

1.21 In Chapter 5 of the Report, we have recommended that leaseholders making a collective freehold acquisition claim should be able to require the landlord to take “leasebacks” of any units within the premises being acquired which are not let to leaseholders who are participating in the claim. This recommendation will make it cheaper for leaseholders to acquire the freehold of their building, because the value of those units will remain with the landlord. However, the result may be that the landlord will then become a leaseholder of a residential unit or units within the premises which the leaseholders have acquired. This raises the question of whether a former landlord in this position should be able to exercise the right to participate in respect of any such unit (where he or she holds the most inferior long lease of that unit). If so, he or she would be able to “buy back in” to the freehold ownership of the premises, and thus continue to have a say in its management.

1.22 We think that a former landlord who receives a leaseback of a residential unit following a collective freehold acquisition claim should be able to exercise the right to participate.

1.23 We accept that this possibility may be unattractive to some groups of leaseholders. Cutting all ties with their landlord is often one of the attractions for leaseholders of exercising the right of collective freehold acquisition in the first place. Consultation responses were divided on this question, with a considerable number of consultees expressing the view that there should be no such right for former landlords. However, we think there is no justification for restricting the right to participate in these circumstances. The former landlord is a leaseholder and should be treated in the same way as other long leaseholders. In any event, it would be easy for a landlord to circumvent any attempt to deprive them of this right. They would simply need to grant a long sub-lease to a related individual or entity, who would then be able to exercise the right to participate instead. The landlord might in any event already hold an existing long lease of a different residential unit in the premises or may purchase the same in the future, and this lease would carry the right to participate. We do not think the right to participate can or should prevent one party who is or has become a leaseholder from exercising a right available to all other leaseholders simply because that party formerly held the freehold interest in the premises.

13 Certain exceptions to such a provision would be necessary, as it is very common for leaseholders to surrender their existing lease as part of the grant of a lease extension after a freehold acquisition claim.
1.24 We have also considered a related procedural question, which arises where an outgoing landlord indicates during the collective freehold acquisition process that they intend to exercise the right to participate in respect of any residential unit they already own on a long lease, or will own as a result of a leaseback. We think that in this scenario it might be desirable to treat the outgoing landlord as a participant in the collective freehold acquisition claim, in respect of the relevant unit(s), and for the premium payable by the leaseholders to be adjusted accordingly. We think this route might be cheaper and more convenient for the parties than requiring the leaseholders to complete the collective freehold acquisition claim and pay a premium to the landlord, only for the landlord immediately to exercise the right to participate and pay some of that money back to the nominee purchaser. However, further work is needed to explore whether an outgoing landlord should be able to exercise the right to participate in this way and to ensure that leaseholders participating in the collective freehold acquisition would not be prejudiced by this approach. For example, we would want to ensure that the landlord does not gain sight of the leaseholders’ legal and valuation advice. We also think that calculating the deduction from the premium for treating an outgoing landlord as a participant may be challenging. Further engagement with stakeholders is required on these and any other issues associated with this proposal.

**When can the right to participate be exercised?**

1.25 We think that a leaseholder should be able to exercise the right to participate at any point after a collective freehold acquisition claim has been completed. There should be no minimum waiting period or longstop date, as suggested by some consultees. To place limitations on when the right can be exercised would, in our view, be contrary to the aim of enabling leaseholders to participate in purchasing their freehold at a time which suits them or whenever they become aware that a collective freehold acquisition claim has been made.

1.26 Since the Consultation Paper was published, we have also considered whether a leaseholder should have a right to join in a collective freehold acquisition claim while it is in progress (that is, if the participating leaseholders are not agreeable to them doing so). This is not the right to participate in the sense which we described in the Consultation Paper, but it is directed at the same policy objective of increasing leaseholder participation in the ownership and management of their buildings. Indeed, it can be argued that it makes a lot more sense than requiring someone to wait until the collective freehold acquisition claim completes to make their right to participate claim.

1.27 However, we have identified some issues with this suggestion which require further consideration. Most significantly, we think it will be difficult to cater for the terms upon which a leaseholder might be entitled to join in a claim which has not yet completed. Existing participants will have agreed the terms of their participation with one another, but they may not be so willing to reach the same agreement with someone who they do not want to join them in the claim. The original participants may in fact withdraw from the whole process if someone joins who they do not wish to join. The difficulty is that, inherently, the process of carrying out a collective freehold acquisition is consensual as between the participators, whereas a right to participate claim is potentially a more “hostile” process pitching one leaseholder against the rest.
1.28 If a right to join in an ongoing claim can be facilitated, however, we think there are also some procedural questions to be considered.

(1) First, it would be necessary to place some restrictions on how this right can be exercised, to ensure that collective freehold acquisition claims can continue to proceed smoothly. In particular, it would not be desirable for a leaseholder to be able to decide to join in a claim at the very last minute, when all terms have been agreed with the landlord. For example, if the original participants had agreed that the landlord would take a leaseback of the flats of non-participating leaseholders, and one of those non-participating leaseholders then seeks to join in the claim at the last minute, the premium payable to the landlord will have to change. There is the potential for costs to be wasted. We think, therefore, that the right should be available up until the point at which terms are agreed between the leaseholders making the claim and the landlord.

(2) Second, if leaseholders can elect to join in a collective freehold acquisition claim while it is in progress, the leaseholders making the claim must be permitted to change matters set out in their claim notice, such as (for example) the elections they have made regarding the leasebacks that they wish the landlord to take.

1.29 We have also considered how a leaseholder who is not part of the original group making the collective freehold acquisition claim might become aware that a claim is on foot, and the means by which they can exercise the right to join in at this stage. We do not think the answer to this problem is the introduction of mandatory notices of invitation to participate in a collective freehold acquisition claim. As we have explained in the Report, a requirement to serve such notices is likely to give rise to a number of practical difficulties, and may in fact lead to difficulties in progressing collective freehold acquisition claims. However, we think that leaseholders who have reason to believe that a collective freehold acquisition claim is underway might be assisted by the ability to serve notice on the landlord requiring him or her to advise whether any such claim has been made and to provide copies of any Claim Notice. This would then enable the leaseholder who wishes to join the claim to learn the identity of the nominee purchaser and to serve a participation notice on the company requesting to join in the claim. The right to join in an ongoing claim would therefore be available from the point at which a formal claim is made to the point at which terms are agreed in respect of that claim.

THE TERMS OF PARTICIPATION AND THE PREMIUM PAYABLE

1.30 In the Consultation Paper, we noted a number of issues that would need to be addressed in order for the right to participate to operate successfully. These issues included the terms upon which a leaseholder exercising the right would be able to acquire a share of the freehold interest, and how the premium payable by that leaseholder ought to be calculated. We think that these issues are linked. What a leaseholder acquires when he or she exercises the right to participate, and on what terms, will necessarily affect the premium that must be paid.

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What does a leaseholder acquire when he or she exercises the right to participate?

1.31 We have described the right to participate as the right to purchase “a share of the freehold interest” held by those who participated in an earlier collective freehold acquisition claim. As we have explained above, we envisage that this right would, in reality, amount to a right to acquire membership of the nominee purchaser corporate body which owns the relevant freehold interest. This outcome follows from our recommendation that leaseholders who make a collective freehold acquisition claim should be obliged to acquire the freehold in the relevant premises in the name of a nominee purchaser which is a corporate body, rather than in their own names.

1.32 On the face of it, simply acquiring membership of the nominee purchaser corporate body would seem likely to put the RTP leaseholder in the same position as the leaseholders who participated in the original collective freehold acquisition claim. This outcome is in line with the first of our general principles set out at paragraph 1.5 above. However, we have identified several reasons why this might not always be the case.

1.33 First, although the leaseholders making a collective freehold acquisition claim will in most cases agree that each of them will become members of the nominee purchaser corporate body, on the same terms, there is nothing to prevent them from reaching a different agreement. A particular example might be where the premium paid to the landlord includes some form of investment value, such as development or hope value. The leaseholders might agree to fund these portions of the premium in unequal shares, with the difference reflected in (say) the allocation of different classes of shares (in a company limited by shares) or different voting rights in the nominee purchaser corporate body. Where this is the case, it will not be possible simply to say that the RTP leaseholder should acquire membership which equates to that of the original participants in the collective freehold acquisition, since the original participants do not all have exactly equivalent membership.

1.34 Second, a right simply to acquire membership of the nominee purchaser corporate body might be problematic where – as is frequently the case – the original participants in the collective freehold acquisition claim have granted themselves new, longer leases (usually of 999 years) following completion of the claim. Where this is the case, the value of the freehold interest will have been substantially reduced. Merely providing for the RTP leaseholder to acquire membership of the corporate body which holds the freehold may not, therefore, produce an equal outcome. The RTP leaseholder will acquire membership of the nominee purchaser corporate body – and therefore a share in the ownership of and say in the management of the freehold – whilst paying a lower premium than the original participants, due to the reduced value of the freehold. It is unclear if this imbalance would necessarily be adequately rectified if the RTP leaseholder later seeks a new, extended lease. Indeed, if all members of the nominee purchaser corporate body are entitled, under the terms of membership, to have a lease extension for free, he or she may be in the fortunate position of paying a reduced premium whilst also being entitled to a lease extension.

1.35 Third, if the original landlord has taken a leaseback of the unit belonging to the RTP leaseholder at the time of the collective freehold acquisition, then the RTP leaseholder will probably wish to buy out that intermediate lease. If the intermediate lease is a 999-year lease, it will hold all of the reversionary value in the unit. This could mean that the
RTP leaseholder will end up paying the full reversionary value of his or her home, yet, if he or she only acquires a share in the nominee purchaser, he or she may not be entitled to a lease extension to realise the value of that payment.

1.36 We have considered whether these concerns could be addressed if the RTP leaseholder were to be granted a very long lease extension of his or her unit (say, 999 years) alongside membership of the nominee purchaser. Where the original landlord was required at the time of the collective freehold acquisition to take leasebacks of non-participants’ flats, the RTP leaseholder could simply purchase the leaseback of his or her flat from the original landlord. Where leasebacks have not been used, the RTP leaseholder could be granted a 999-year lease of his or her flat by the nominee purchaser.

1.37 This option is preferable when the original participants in the collective freehold acquisition claim have also granted themselves 999-year lease extensions – all the leaseholders will end up with the same interest. But of course this will not always be the case. Whilst the ability for participating leaseholders to extend their leases is one advantage of a collective freehold acquisition claim, it is not a given. Under the current law and under our recommendations, the participants will decide between themselves whether to extend their leases and, if so, by how long and on what terms. Providing for the RTP leaseholder to receive a new 999-year lease on exercise of the right is not necessarily going to align his or her interest with that of the original participants. If RTP leaseholders are to be automatically entitled to a 999-year lease, they may immediately hold a more valuable asset than the other leaseholders.

1.38 The difficulties set out above indicate that there is no easy answer to what a leaseholder should acquire when he or she exercises the right to participate. These difficulties are an inevitable consequence of the fact that collective freehold acquisition claims are consensual and can involve a degree of variation. The first option – simply giving the RTP leaseholder membership of the nominee purchaser corporate body – appears to work in cases where the original participants have not extended their leases and all hold membership of the corporate body on the same terms. The second option – additionally giving the RTP leaseholder a lease extension – may work where the original participants have extended their leases, although the nature of these lease extensions may vary.

1.39 Our recommendations in Chapter 5 of the Report seek to streamline certain aspects of the collective freehold acquisition process. However, we have not sought to ensure that all collective freehold acquisitions lead to the same outcome – for example, to prescribe that all leaseholders carrying out a collective freehold acquisition must acquire equivalent membership of the nominee purchaser corporate body and grant themselves lease extensions of a particular length as part of the transaction. It feels instinctively contrary to the nature of a collective freehold acquisition claim – which is intended to give the participants control over how their homes are owned and managed – to prescribe precisely how the ownership of the premises must be

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15 In the Report, at para 3.62, we recommend that, where a leaseholder claims a statutory lease extension, he or she should be entitled to have an additional period of 990 years added to the remaining term of the existing lease. That recommendation would not apply where participants in a collective freehold acquisition grant themselves new leases, though as a matter of practice the grant of 999 years, which is common at the moment, may change to 990 years to match our recommended period for a lease extension.
structured. Nevertheless, we think that unless the outcome of collective freehold acquisition claims is prescribed in such a way, it is likely to be difficult to make provision as to exactly what the RTP leaseholder should acquire on exercising the right to participate. Moreover, if RTP leaseholders may acquire different interests in different situations, the value of the right to participate is likely to vary across these different cases. Attempts to exercise it are therefore likely to be challenging, with the potential for disputes to arise.

1.40 We have considered how the right of collective freehold acquisition might be more tightly prescribed in order to better facilitate a uniform right to participate. It might be possible, for example, to require that all nominee purchaser corporate bodies are required to adopt articles of association (or another constitutional document) which provide for:

(1) membership to be restricted to leaseholders in the premises acquired who either participated in the original collective freehold acquisition claim or have subsequently exercised the right to participate;

(2) each member to hold membership on identical terms and with identical voting rights, amounting to one vote per residential unit;\(^{16}\)

(3) each member (whether they are an original participant or an RTP leaseholder) to be entitled to a new, extended lease of a prescribed length at a peppercorn ground rent; and

(4) all of the above provisions to be incapable of being altered.

1.41 Provisions such as these would ensure that all leaseholders who participate in a collective freehold acquisition claim have the same rights thereafter, and would make it possible to ensure that RTP leaseholders can join in the ownership and management of the relevant premises on the same terms. However, it is obvious that to require collective freehold acquisition claims to be carried out on these terms and no others would significantly restrict the freedom which leaseholders currently have to enter into an ownership and management arrangement which suits their individual circumstances. In particular, it may often be appropriate for different leaseholders to hold different shares or different voting rights, most likely where the purchase price for the freehold has been paid for in different proportions by different leaseholders.

1.42 This issue provides a clear example of the kinds of limitations which the introduction of the right to participate may impose on the freehold ownership which leaseholders acquire following a collective freehold acquisition claim. We think that it is necessary to explore with stakeholders the effect such limitations might have on leaseholders, and whether there might be other means of facilitating the right to participate without adopting such a restrictive approach to collective freehold acquisition claims.

\(^{16}\) If differential voting were permitted, it would be impossible to calculate what share of the vote the leaseholder exercising the right to participate would have negotiated if they had participated originally.
What must a leaseholder pay to exercise the right?

1.43 How much the RTP leaseholder must pay for the exercise of the right to participate will depend, in the first instance, on how the issues discussed in the preceding section of this note are resolved: in simple terms, the leaseholder must pay for the interest which he or she is to acquire. Whatever that interest is, though, we think the RTP leaseholder should pay its market value at the time he or she exercises the right to participate. We acknowledge that many factors, including the value of the freehold and the length of any relevant long leases, are likely to have changed since the time of the original collective freehold acquisition claim. But we do not think, as some consultees suggested, that it would be right to “freeze” the premium payable for the exercise of the right to participate in line with that paid by the original participants in the collective freehold acquisition claim. This approach would not reflect the real value of the right to participate at the time it is exercised. Nor would it assist in our policy aim of increasing participation in collective freehold acquisitions at the outset, since leaseholders would know that they do not run the risk of having to pay more at a future date if they choose not to participate in the original claim.

1.44 We have considered some additional specific questions and set out our provisional views as follows.

(1) There is a question as to whether the RTP leaseholder should be required to contribute towards the cost of any investment value (as further explained at paragraph 1.5 above) which was included in the premium for the original collective freehold acquisition. The first of our general principles set out at paragraph 1.5 is that the exercise of the right to participate should place the RTP leaseholder in the same position (or as near as possible thereto) as if they had participated in the original collective freehold acquisition claim. However, the payment of investment value is often the subject of an agreement between leaseholders participating in a collective freehold acquisition claim, tailored to their individual financial resources, rather than the cost simply being split equally between them. There is no way of establishing what agreement might have been reached around the payment of investment value if the RTP leaseholder had been involved in the original claim. The fact that the RTP leaseholder is as a matter of fact joining in later cannot simply be ignored. Accordingly, we think that the RTP leaseholder should be required to pay only for the appropriate share of the value of the freehold excluding investment value. It follows that the RTP leaseholder should not derive any financial benefit where such investment value is subsequently realised.

(2) On the other hand, if investment value has accrued to the freehold title since the original collective freehold acquisition claim completed (for example, due to the relaxation of planning regulations), we think that this value should be taken into account in calculating the premium which the RTP leaseholder has to pay. The additional value has arisen because of changes in the real world, which happen to benefit the original participants and to add to the cost for someone seeking to purchase the freehold (or a share of it) later. The same difficulty with establishing what the RTP leaseholder would have paid for that value does not arise, since it did not form part of the original premium. It follows that the RTP leaseholder should be able to benefit where this kind of investment value is subsequently realised.
Another question which some consultees raised is how any premium paid by the RTP leaseholder is to be distributed. We think that it should be paid to the current members of the nominee purchaser corporate body. This may mean that premiums are paid to the successors in title of the leaseholders who participated in the original collective freehold acquisition claim. We agree with consultees’ concerns around locating leaseholders who may have moved on many years ago. We think that the onus should be on a leaseholder who is a member of the nominee purchaser to agree a price, when selling their lease, which reflects any hope value or development value to which they are entitled – or, indeed, to negotiate an overage provision if they wish.

Beyond our initial views set out above, we think that further work and discussion with stakeholders is required to devise an appropriate regime to calculate the premium payable by an RTP leaseholder.

COSTS

Almost as important as the question of the premium to be paid by an RTP leaseholder is the question of how the costs of making and responding to a right to participate claim are to be paid. There is also the question of whether the RTP leaseholder should contribute towards the costs which the original participants incurred when making the collective freehold acquisition claim.

The costs of the right to participate claim

We think that the costs of making and responding to a right to participate claim should be borne by the RTP leaseholder and by the nominee purchaser corporate body respectively. We do not think that the RTP leaseholder should be required to make any contribution to the nominee purchaser’s non-litigation costs of dealing with the right to participate claim. Our reasoning is that if the original participants know that they will be required to fund the cost of dealing with future right to participate claims, they may be more likely to seek to maximise participation in the original collective freehold acquisition claim. This accords with the policy aim of encouraging maximum participation in collective freehold acquisition claims from the outset which underlies our proposal for the right to participate.

The costs of the original collective freehold acquisition claim

On the other hand, we think that the RTP leaseholder should pay a contribution towards the costs incurred by the original participants in making the collective freehold acquisition claim. The RTP leaseholder would have paid a share of those costs had he or she participated in the original claim and we think it is fair that he or she should do so if joining in the benefit of that claim later. Otherwise, leaseholders might be inclined to wait and exercise the right to participate later, rather than to participate in a collective freehold acquisition claim, since the costs of exercising the right to participate are likely to be lower than one leaseholder’s share of the costs of a complete collective freehold acquisition claim.

We have considered several ways in which the RTP leaseholder’s contribution to the costs of the collective freehold acquisition claim could be ascertained.
(1) The RTP leaseholder could be required to pay 1/n of the costs of the original acquisition ("n" being the number of units in the block), plus inflation. This method is straightforward, but we recognise that it would result in the RTP leaseholder paying a smaller proportion of costs than those who participated in the original collective freehold acquisition, until all the leaseholders in the premises have exercised the right to participate. This disparity might be considered inherently unfair, and could be a disincentive for those who would otherwise participate in the original claim.

(2) The RTP leaseholder could be required to pay 1/n of the costs of the original acquisition ("n" being the number of leaseholders who will have participated and become members of the nominee purchaser once the right to participate claim completes), plus inflation. This formula ensures that the costs are distributed evenly between those who have participated in the claim at the point at which the right to participate claim completes. However, the costs would need to be recalculated each time another leaseholder exercises the right to participate.

(3) The RTP leaseholder could be required to pay a flat fee. This approach has the benefit of simplicity, but it could over- or under-compensate the participants.

1.50 Another question we have considered is to whom the RTP leaseholder’s contribution to the costs of the original claim should be paid. The costs of the original claim could have been paid by the leaseholders in any agreed proportions. If the contribution payable by the right to participate leaseholder is to be distributed amongst the original providers of those funds, then those individuals (or companies) will need to be traced. This could be difficult if they have since sold their leases and their corresponding interests in the nominee purchaser. In addition, it may be that no records are retained showing who paid what proportion of the costs. Therefore, we think that the costs contribution should be paid in the first instance to the nominee purchaser. Along with the matters identified at paragraph 1.40 above, the nominee purchaser’s articles of association (or other constitutional document) could be required to include provision for how such contributions are to be distributed between the members.17

SECURING THE AVAILABILITY OF THE RIGHT TO PARTICIPATE

1.51 A key motivation behind our proposal for the right to participate was a desire to help those leaseholders who are not invited to participate in a proposed collective freehold acquisition claim. We considered that it is unfair for those leaseholders to be excluded – often permanently – from the ownership and management of their building which their neighbours will go on to enjoy following completion of the claim. In addition, it is not conducive to good neighbourly relations for some leaseholders in a building to feel that they have been excluded from participation by those who have become their landlords.

1.52 However, given that such leaseholders are in some cases deliberately excluded by the leaseholders who are participating in a claim, it will be necessary to ensure that the right to participate cannot be frustrated or avoided by a nominee purchaser if it is

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17 As with the distribution of the premium, discussed above at paragraph 1.44(3), it is for a leaseholder who contributed towards the costs of the original claim, when selling their lease, to ensure that the price agreed reflects the possibility of a costs contribution being received from an RTP leaseholder subsequently.
to serve its intended purpose. We think that devising appropriate anti-avoidance mechanisms to secure the availability of the right to participate is one of the biggest issues to be addressed if the right to participate is to be successfully introduced.

1.53 A related question is how leaseholders who were not aware that a collective freehold acquisition claim was being made (whether because they were deliberately excluded or not) will be aware that the right to participate is available to them subsequently.

Avoiding the application of the right to participate

1.54 On the face of it, our proposal sounds straightforward: the right to participate should be available wherever there has been a successful collective freehold acquisition claim. But what exactly do we mean by a successful collective freehold acquisition claim? There can be little argument that one has occurred where a group of leaseholders serves a Claim Notice to acquire the freehold of their building in accordance with the procedure we recommend in the Report, and the freehold has thereafter been transferred to the nominee purchaser named in that notice. But what if no Claim Notice has ever been served, or the freehold is transferred to an entity which is not the nominee purchaser named in a Claim Notice?

1.55 We think that leaseholders who wish to exclude other leaseholders might attempt to prevent the application of the right to participate by seeking to acquire the freehold from their landlord outside of the statutory collective freehold acquisition scheme. For example, they might try to negotiate a “voluntary” purchase of the freehold from their landlord, which does not involve the service of a Claim Notice. Alternatively, as a claim reaches its final stages, they might request that the landlord transfers the freehold to a company or to individuals other than the nominee purchaser named in the Claim Notice. We do not think that the “right of first refusal” provisions of the Landlord and Tenant Act 1987 – which prevent a landlord of a building containing flats let on long leases from selling his or her freehold interest without first formally offering it to the leaseholders in the building – would prevent this kind of behaviour. In fact, the 1987 Act process could be used to shield an agreement between the landlord and a group of leaseholders for the sale of the freehold to those leaseholders outside of the statutory collective freehold acquisition scheme. Once such an agreement is reached, the landlord could simply give notice to all of the leaseholders in the building offering to sell them the freehold at the price agreed with the participating leaseholders, but once this notice expires the participating leaseholders would be free to acquire the freehold at that price.

1.56 Of course, there will be many landlords who will not co-operate with these kinds of requests from leaseholders, but there might be others who will – we can even envisage that some landlords might see such requests as a means of being able to extract a higher premium from leaseholders who are particularly keen to exclude one or other of their neighbours. On this basis, we are also concerned not to encourage a two-tier system under which voluntary transactions would command a higher premium than statutory transactions.

1.57 We have considered whether it might be appropriate to seek to prevent voluntary transactions such as these, or require all sales by landlords to leaseholders to be made to a prescribed nominee purchaser. However, we think that any provision which seeks to prevent voluntary collective freehold acquisition transactions would be
impossible to enforce. A suitably determined group of leaseholders could always find a way to exclude other leaseholders – such as by purchasing the freehold via a special purpose company, or in the name of another individual or group of individuals. In any event, we consider that it would be beyond our terms of reference to seek to regulate the means by which a sale to leaseholders is carried out under the 1987 Act.

**Blocking awareness of the right to participate**

1.58 Even where a collective freehold acquisition does take place in the ordinary way, pursuant to a Claim Notice, it is unclear how non-participating leaseholders are to become aware that the right to participate is available to them. There is no way of finding out whether a Claim Notice has been served – there is no register or other record of such notices. And although a new landlord is obliged to inform leaseholders of the change of landlord, and his or her name or address, this will not necessarily reveal that the new landlord is a group of leaseholders. Participating leaseholders could give the company any name they wish, appoint external directors, and grant membership of the company to related individuals rather than to themselves if they really wished to prevent the excluded leaseholders from seeking to exercise the right to participate. We think that further consideration is needed as to how leaseholders can be made aware that there has been a collective freehold acquisition claim in relation to their building and that they are therefore able to exercise the right to participate.

**Frustrating the operation of the right to participate**

1.59 We do not think that avoidance mechanisms of the kind described above are especially likely to be used, as they would require a very motivated group of leaseholders, as well as (in some cases) a co-operative landlord. We think that leaseholders are more likely simply to enter into dealings with the freehold title that they have acquired, in order to make it impossible for the right to participate to operate later. In particular, we think that there is a risk that leaseholders would attempt to transfer the freehold title out of the name of the nominee purchaser with the required prescribed articles and into the name of a different entity or the names of individuals.

1.60 It was for this reason that we proposed in the Consultation Paper that after a collective freehold acquisition has taken place, the nominee purchaser should not be able to dispose of the premises unless all qualifying leaseholders were members of the company and agreed to make the proposed transfer, or the proposed transfer had approval from the Tribunal. However, this proposal was not popular with consultees and a number told us it would render the freehold worthless. We think this issue requires further consultation with stakeholders and, in the meantime, we have considered other means by which the right to participate could be protected.

1.61 First, we have considered whether we could provide a remedy for an aggrieved leaseholder who is unable to exercise the right to participate because the nominee purchaser has disposed of the freehold in a way designed to frustrate the exercise of

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18 We reach this conclusion in Ch 14 of the Report, where we discuss the possibility of regulating the ability of parties to enter into a collective transfer of the freehold that is not “on statutory terms”: see paras 14.104 to 14.122.

19 Landlord and Tenant Act 1985, s 3.
the right to participate. However, we have identified several difficulties with that approach.

(1) It is unclear what the appropriate remedy would be. If damages are considered appropriate, what would be the measure of damages, and against whom would the award be enforceable? It can be assumed that the original participants would presumably put the nominee purchaser into liquidation as soon as the transaction completes.

(2) Any cause of action might only extend to protecting those leaseholders who owned their leases before the nominee purchaser disposes of the freehold. It might be difficult to argue that a sale of the freehold was designed to frustrate the right to participate of a leaseholder who only acquires their interest in the relevant premises many years later.

(3) If an appropriate sanction can be found, the prospect of facing a potential legal claim is still going to operate as a fetter on the nominee purchaser’s freedom to sell the freehold and as such may still render the freehold worthless.

1.62 Second, we have considered whether the right to participate scheme could be designed to protect only those leaseholders who own their leases at the time the original collective freehold acquisition claim is made. This would mean that any ban on onward disposals of the freehold would be time-limited, applying only until all qualifying leaseholders exercise the right to participate, or sell or transfer their flat. However, this approach would change the right to participate from a continuing, transferable right to an opportunity for certain individuals, which is a less beneficial right for leaseholders generally and contrary to the last of our general principles set out at paragraph 1.5 above. Additionally, we do not think that this approach would necessarily be considerably better for the participants in the original collective freehold acquisition, who may not be able to sell the freehold for many years if just one non-participating leaseholder from the time of the original claim remains in place.

1.63 Overall, it seems to us that the challenge of ensuring the right to participate cannot be frustrated by the actions of the original participants reveals a fundamental tension between two competing ideals. The right to participate, on the one hand, is rooted in fairness and the sharing of control, whereas the concept of freehold ownership, on the other hand, carries connotations of almost complete control and the ability to deal freely with one’s land. For the right to participate to operate successfully, it is likely to be necessary to depart from traditional concepts of freehold ownership and to restrict, in one way or another, what the owners of land can do with their land. We think that there is a need to explore with stakeholders how far it is justified to impose limits on the rights of the current owners of the freehold in the interests of protecting the rights of others which may potentially be exercised in the future.